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Supreme Court of the United States

OCTOBER TERM, 1965

No. 487

WILLIAM MALAT, ET UX., PETITIONERS,

vs.

ROBERT A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 23, 1965

CERTIORARI GRANTED NOVEMBER 8, 1965

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965

No. 487

WILLIAM MALAT, ET UX., PETITIONERS,

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ROBERT A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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[fol. 1]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

v.

ROBERT A. RIDDELL, District Director of Internal Revenue, Defendant.

AMENDED PRE-TRIAL CONFERENCE ORDER—Filed February 4, 1964

I

This is an action for:

Refund of federal income taxes plus interest paid thereon, together with interest on the amount paid as allowed by law.

II

Federal jurisdiction is invoked upon the ground:

(A) That the defendant, Director of Internal Revenue, allegedly illegally collected from the plaintiffs internal revenue taxes allegedly erroneously assessed against plaintiffs and the District Court has jurisdiction of such a cause of action under 28 U.S.C. Section 1340.

(B) That the plaintiffs have timely filed claim for refund of said amount collected, that at the time this suit was filed more than six months had elapsed after the filing of [fol. 2] said claim, without action taken thereon by defendant, and that after the filing of this suit, and on September 10, 1962, said claim was formally rejected by defendant.

III

The following facts are admitted and require no proof:

(A) Plaintiffs are individuals with address at 8730 Wilshire Boulevard, Beverly Hills, California.

(B) On or before April 15, 1957, plaintiffs, as husband and wife, filed their joint federal income tax return for the taxable year 1956 with the District Director of Internal Revenue at Los Angeles, California, and paid taxes shown thereon in the amount of $42,341.47.

(C) On or before February 9, 1960, plaintiffs were assessed a deficiency in income tax for the taxable year 1956 in the amount of $4,905.61 together with interest thereon.

(D) On February 17, 1960, plaintiffs paid said deficiency assessment of income tax in the said amount of $4,905.61 plus interest thereon; the total so paid was $5,531.41.

(E) On June 8, 1961, plaintiffs duly filed a timely claim for refund for a portion of the aforesaid deficiency payment, the refund so claimed being $1,231.22.

(F) The basis of the claim for refund is stated therein as follows:

> "Taxpayer was a member of a partnership known as Louis Lesser Enterprises which derived income from another partnership known as Century Crenshaw Plaza. The land held by Century Crenshaw Plaza was held for investment and is entitled to capital gains treatment. Internal Revenue Agent's report dated September 28, 1959, claimed this to be ordinary income. Taxpayer takes exception to this finding and claims the sale of this property to be a capital gain transaction."

[fol. 3] (G) On July 12, 1962, a statutory notice of the disallowance of said claim was sent to the plaintiffs by certified mail. No part of the repayment demanded, nor interest paid thereon, has been credited, remitted, refunded

or repaid to plaintiffs or to anyone on their account. On or about March 5, 1963, within a period of two years after said disallowance of said claim, plaintiffs filed the complaint in the present action.

(H) The said Century Crenshaw Plaza, hereinafter referred to as "Plaza", was a joint venture organized August 12, 1953, with Louis Lesser Enterprises, Ltd., a partnership (hereinafter referred to as "Lesser"), as one of its members. The other members were Maxwell J. Fenmore (hereinafter referred to as "Fenmore"), Sidney Rogen, Herman C. Millman, and Carl N. Hicks (hereinafter referred to as "Hicks"). Each member had a 20 percent interest in the capital and profits of Plaza. The original contributions to Plaza by its members consisted of cash.

(I) During 1953 and at all times pertinent to this action plaintiff William Malat was one of the members of Lesser.

(J) Prior to the organization of Plaza, Lesser and the other members of Plaza negotiated for the acquisition of a 44.901 acre parcel of real estate known as Timothy-Riordan Ranch, located at Century and Crenshaw Boulevards, Inglewood, California. On or about August 12, 1953, Plaza opened escrow for the purchase of said property for the sum of $486,000.00. On February 15, 1954, the escrow was closed on the acquisition by Plaza of the said property.

(K) On April 26, 1954, Plaza distributed 24.646 acres of said property to its members as equal tenants in common, subject to the liens and encumbrances of record. On May 26, 1954, the distributees transferred the property, subject to the liens and encumbrances of record, to a joint venture under the name of Century Crenshaw Properties Co. (hereinafter referred to as "Properties"). The mem-
[fol. 4] bers of Properties were Lesser, said Sidney Rogen, said Herman C. Millman, Espada Properties, Inc., a California corporation, and Hicks Properties, Inc., a California corporation. Each member owned a 20 percent interest in the capital and income of Properties. Fenmore was con-

trolling stockholder of Espada Properties, Inc., and Hicks was controlling stockholder of Hicks Properties, Inc.

(L) Plaza allocated the total cost basis of the 44.901 acres, $486,000.00, as follows: The said 24.646 acres distributed to its members, $266,765.40; the remaining 20.255 acres retained by Plaza, $219,234.60.

(M) The said 24.646 acres was subdivided, as Tract 19705 into 105 lots. Properties sold the said 105 lots, and reported the gains thereon as ordinary income. The members of Properties likewise reported their distributive shares of the said gains as ordinary income in their respective income tax returns.

(N) On or about October 15, 1954, Plaza, out of said 20.255 acres retained by it, sold 9 plus acres, fronting on Century Boulevard, to Hicks-Fenmore Development Company (hereinafter referred to as "Development Co.") for $123,781.70. Development Company was a four-way partnership consisting of Hicks, Fenmore, and two corporations controlled by Hicks and Fenmore, respectively. On or about November 5, 1954, Plaza sold the remainder of said 20.255 acres, being 10.9 acres fronting on Crenshaw Boulevard, to one George Ponty, for $222,800.00. (It is not thereby implied that the said George Ponty made the said purchase, either partially or entirely, on his own behalf.)

(O) Ponty was a real estate developer.

(P) Gains from sale of said 20.255 acres were reported as long-term capital gains for the fiscal years 1955, 1956 and 1957 on the returns of Plaza.

[fol. 5] (Q) The Internal Revenue Service made an examination of the returns of Plaza for said three fiscal years, and on September 21, 1959, issued its Revenue Agent's Report for Plaza reclassifying the said gains as ordinary income.

(R) Said reclassification as ordinary income was grounded in said report on Section 1237 of I.R.C. 1954.

(S) The Internal Revenue Service also made an examination of the returns of Lesser and of plaintiffs herein, and on September 28, 1959, issued Revenue Agent's Reports covering such examination. On December 3, 1959, it issued a revised Revenue Agent's Report covering the examination on plaintiffs. In the report for Lesser several adjustments were made, including the reclassification of the amount of $15,391.50 for its year ended in 1956, from capital gain to ordinary income upon the basis of the said Revenue Agent's Report for Plaza. In the report for plaintiffs several adjustments were also made, including the reclassification for 1956 of an amount computed at $1,710.16 from capital gain to ordinary income upon the basis of the said reclassification of $15,391.50 in the Revenue Agent's Report for Lesser.

(T) The Commissioner then assessed deficiencies against the members of Lesser, including plaintiffs herein, for 1956, on the basis of the said Revenue Agent's Reports.

(U) Said claim for refund was disallowed in full by notice mailed to plaintiffs by defendant on September 10, 1962.

IV

The reservations as to the facts recited in paragraph III are as follows:

(A) Defendant admits the truth of the facts stated in subparagraph (R) of paragraph III, but does not admit the relevancy or materiality of said facts.

[fol. 6]

V

There are no facts in the category not admitted but not to be contested at the trial by evidence to the contrary.

VI

The following issue of fact, and no others, remains to be litigated upon the trial:

(A) Whether Plaza, Lesser, and Malat, and each of them, held the said 20.255 acres of land primarily for sale to customers in the ordinary course of trade or business.

VII

The exhibits to be offered at the trial, together with a statement of all admissions by and all issues between the parties with respect thereto, are as follows:

(A) Plaintiffs' exhibits:

(1) Revenue Agent's Report on the partnership Century-Crenshaw Plaza for its fiscal years ended 1/31/55, 1/31/56, 1/31/57.

(2) Revenue Agent's Report on the partnership Louis Lesser Enterprises, Ltd. for its fiscal years ended 6/30/55 and 6/30/56.

(3) Revenue Agent's "Revised Report" on plaintiffs for the years 1955-1956.

(4) Sketch relating to the 44.901 acre parcel of real estate acquired by the partnership Century-Crenshaw Plaza.

(5) Certificate of C-2 variance granted November 30, 1954 to Carl N. Hicks on behalf of Hicks-Fenmore Development Company.

(B) Defendant's exhibits:

[fol. 7] (1) United States Partnership Return of Income (Form 1065) filed by Louis Lesser Enterprises, Ltd. for the taxable year ending June 30, 1956; and

(2) United States Individual Income Tax Return (Form 1040) filed by William and Ethel Malat for 1956.

Plaintiffs and defendant may find it essential to their positions to offer still other exhibits at the trial.

VIII

The following issue of law, and no others, remains to be litigated upon the trial:

(A) Whether Plaza, Lesser, and Malat, and each of them held the said 20.255 acres of land primarily for sale to customers in the ordinary course of trade or business.

Plaintiffs will contend, however, that the said issue is only an issue of fact.

IX

The foregoing admissions having been made by the parties, and the parties having specified the foregoing issues of fact and law remaining to be litigated, this order shall supplement the pleadings, supersede the Pre-Trial Conference Order filed on December 30, 1963, and govern the course of the trial of this cause, unless modified to prevent manifest injustice.

Dated: February 3rd, 1964.

E. Avery Crary, United States District Judge.

[fol. 8] Approved as to form and content:

George T. Altman, Esq., Attorney for Plaintiffs.

Francis C. Whelan, United States Attorney;
Loyal E. Keir, Assistant United States Attorney, Chief, Tax Section;
James S. Bay, Assistant United States Attorney, Attorneys for Defendant.

[File endorsement omitted]

[fol. 9]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue, Defendant.

MEMORANDUM OPINION FOR USE IN PREPARING PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW, AND JUDGMENT—March 17, 1964

The plaintiffs, partners in Louis Lesser Enterprises, Ltd., a partnership, hereafter referred to as "Lesser", seek refund of income taxes, plus interest, paid for the year 1956. The court here adopts the admitted facts as set forth in the amended Pre-Trial Order.

The principal issue is whether 20 + acres, sold in two parcels in October and November, 1954, were *held* by Century-Crenshaw Plaza, hereafter referred to as "Plaza", a joint venture, with "Lesser" as one of the partners, primarily for sale to customers in the ordinary course of trade or business.

One of the parcels (10 + acres) of the 20 acres involved fronted on Crenshaw Boulevard and the other (9 + acres) on Century Boulevard. The said two parcels were a part of 44.90 acres which were acquired in February, 1954, by "Plaza", of which "Lesser" was a partner. "Plaza" was [fol. 10] organized in August, 1953, for the purpose of purchasing the said 44 + acres. It is the position of the plaintiffs that the purpose of acquisition was to develop the two

frontage parcels for commercial use and the remaining 24 + acres as multiple residence property also to be held by "Plaza" for rental purposes. Efforts to have the two parcels zoned for commercial use and to develop the 24 acres as planned failed. The Planning Commission refused to rezone the two parcels, and the mortgage market was so weak, plaintiffs assert, that a loan could not be obtained to build apartments on the 24 acres from a practical business standpoint. The inside 24 + acres were distributed by "Plaza", in April, 1954, to its members as equal tenants in common. On May 26, 1954, the distributees transferred the property to a joint venture under the name of Century Crenshaw Properties Company, which consisted of "Lesser", Sidney Rogan, Herman Millman, Espada Properties, Inc., and Hicks Properties, Inc. Fenmore was a controlling stockholder of Espada and Hicks was the controlling stockholder of Hicks Properties. This group subdivided the 24 + acres and the resulting lots were sold during the period from two to nine months after acquisition. Gains from the sale of lots were reported as ordinary income. It appears from the testimony of plaintiff William Malat that if the zoning of the two front parcels for commercial use could not be obtained that "Plaza" intended to build apartments on them for rental but was prevented by the "rough" mortgage market.

After failure to obtain the rezoning of the front parcels, a rift arose among the partners of "Plaza" with "Lesser", Millman and Rogan on one side and Hicks and Fenmore on the other. The rift resulted in acrimony between the said partners that made further business relations as [fol. 11] partners unpleasant, and about October 15, 1954, "Plaza" sold the said 9 + acres fronting on Century Boulevard to Hicks-Fenmore Development Company, a partnership, and about November 5, 1954, "Plaza" sold the 10 + acres on Crenshaw to George Ponty, and gains from said sales were reported by the partners as long term capital gains. From the testimony of plaintiff William Malat during the trial, it appears to the court that it is the position

of plaintiffs that the sale of the two parcels involved was for a threefold reason:

1. Inability to get the property rezoned for commercial uses.
2. Inability to get mortgage money to build apartments on terms which would make such construction practical.
3. The acrimonious rift between the partners which, plaintiffs state, precipitated the sale.

The Government, for the purpose of evidencing the intent on the part of the plaintiffs insofar as concerns the acquiring and *holding* by "Plaza" of the frontage properties, points to testimony of the plaintiff, William Malat, given in his deposition taken in the case, commencing at page 11, line 24, thereof, where the plaintiff observes that the possibility of failure of rezoning or refinancing is always a possibility in real estate development and that if this could not be accomplished re the parcels involved "• • • we would sell the whole thing off in bulk. We wouldn't get hurt," and at page 13, line 4, "If you don't get the zoning, then you do the next best thing. You either develop it at some lesser zoning or sell it off in bulk." At page 24, line 13, of his deposition, plaintiff, in referring to the parcel on Century sold to Hicks-Fenmore Develop-
[fol. 12] ment Company, states, "Their property was still R-3 when we sold it and as far as we knew it was one of the reasons we sold it. We couldn't get it zoned commercially • • •."

Now to the question as to whether the partners, including plaintiffs, held the said two frontage parcels primarily for sale to customers in the ordinary course of trade or business. The statute involved, to wit, § 1221(1) of the Internal Revenue Code of 1954, being one containing relief provisions, is to be strictly construed. The Supreme Court of the United States has held that statutory provisions

granting favorable tax treatment to gains on the sale of capital assets held for more than six months are such relief provisions. *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260, at page 265 (1958). See also *Corn Products Co.* v. *Commissioner*, 350 U.S. 46 at page 52, where the court states, referring to Section 117 a of the Internal Revenue Code of 1939, provisions of which are similar to the Section here involved:

> "It was intended 'to relieve the taxpayer from. . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' *Burnet* v. *Harmel*, 287 U.S., at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly."

The Court of Appeals, 9th Circuit, in the case of *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 at 266 (1951), states that the reason for acquisition is not controlling [fol. 13] unless it is found to be the same as the reason for which the property is *held*. Although the purpose for which acquired is of some weight, the court says:

> "The ultimate question is the purpose for which the property is held."

Plaintiffs, in the case at bar, have, for a number of years, been engaged in the purchase of property for development as an investment. They have frequently held interests as partners and stockholders in businesses holding properties for development and income where, in isolated cases, a portion of the unimproved real estate was sold as lots or raw land. The evidence shows that such sales were infrequent. The court recalls only three being referred to by plaintiff.

A test applied in determining the purpose for which the property was held is "the frequency and continuity of the

transactions claimed to result in a trade or business." Pg. 266, Rollingwood Corp., supra. Applying the test in the case at bar, it does not follow that it supports the contention that the plaintiffs were in the business of selling real property. It appears from the testimony of plaintiff read into evidence from his deposition, referred to above, that the property here in question was purchased with the thought in mind that if the rezoning or appropriate financing could not be accomplished that the parties "would sell the whole thing off in bulk. We wouldn't get hurt." It is also noted that the idea of building apartments or multiple dwellings on the inside 24 + acres was abandoned within a *few weeks* after acquisition (February 15, 1954). The date of distribution of said acres (April 26, 1954) to the individual partners was promptly followed by subdivision.

In *Lowery* v. *Commissioner*, 23 T.C.M. 152 (1964), cited [fol. 14] by plaintiffs, the taxpayer, a real estate broker, occasionally bought and sold real estate. In determining the three properties there involved were not held primarily for sale to customers in the ordinary course of business but for investment, the court observed, at page 156:

> "In making this determination the courts have relied upon various factors including the following: (1) The intent of the taxpayer with respect to the particular asset in question; (2) the purpose for the acquisition and disposition of the property; (3) the period the property was held; (4) the number, frequency and substantiality of sales; and (5) the extent of development, improvement, and sales activity."

Later, on the same page, the court says:

> "* * * we give particular weight to the fact that Lowery had held the 21st Street and Church Lane property for five years, the Gates Street and Ridge Avenue property for three years, and the Rhawn Street tract for two years. We also considered the facts that Lowery made no overt efforts to list or advertise the

properties and he had made no improvements on any of the properties nor did he replace them by further purchases. In 1953 he held the properties for investment."

The taxpayers in *Leeb* v. *Commissioner*, 12 T.C.M. 256, also relied on by plaintiffs, were members of a partnership formed for the purpose of buying 42 acres of unimproved real estate purchased in June, 1945. The property was acquired for subdivision. Block A, a 6 acre portion of the tract, after preliminary study by architects, was not in- [fol. 15] cluded in the site plan nor in a map prepared in May, 1947, as not being economically practical for use in the subdivision planned. The remaining 36 acres were subdivided and sold to the public. Block A was never improved or subdivided nor mapped for subdivision. The plat of the subdivision was recorded in May, 1947. Block A was sold on January 30, 1948. In holding that the sale of Block A was properly taxed as capital gains, the court observed at page 261 of its opinion, re the intention of the parties in holding Block A:

> "But the initial purpose for which property is acquired and held is not conclusive. The determining factor is the purpose for which such property is held at the time a sale thereof is consummated. Thus, property originally purchased and held for sale to customers in the ordinary course of a taxpayer's business as a dealer may subsequently be converted into a capital asset as property held for investment and/or speculation purposes of the taxpayer. See *Pacific Affiliate, Inc.*, supra; *Carl Marks & Co.*, supra. In determining whether such conversion actually in fact was effected, consideration must be given to all material facts, the inferences and conclusions fairly to be drawn therefrom."

The court also notes that no effort was made to sell Block A, no sales solicited, it was not advertised for sale, no

"For Sale" signs were ever displayed thereon and it was never listed for sale with any broker. The evidence showed that Block A was held "for future use as a site for an apartment development later to be erected by them * * * to be held by them as a rental income producing investment." [fol. 16] The Commissioner's determination that Block A was held by taxpayers primarily for sale to customers in the ordinary course of trade or business, was reversed.

In another case cited by plaintiffs, *Edwards* v. *Commissioner*, 12 T.C.M. 1045 (1953), the real estate involved was purchased in 1945 for construction of a hotel, garage, and so forth. These plans failed because of a city zoning ordinance passed in *1946* prohibiting such building on the property. The taxpayers had been actively engaged in the field of construction and building materials. After attempts to have the property rezoned had failed, the tract was listed for sale. A unit sale failed and the property was subdivided into twelve lots and these lots sold during the period from 1947 to 1948, some two to three years after the property was acquired. The Tax Court found that "the purchase and sale of the property was an isolated transaction and was not part of their business (pg. 1047). All of the authorities comment on the point that the question involved is one of fact to be determined with regard to the particular facts in each case.

Again referring to the Rollingwood Corporation case (9th Cir.), supra, we find that the petitioners, Rollingwood Corporation (hereafter referred to as R Corp.), and Bohannon, unsuccessfully contended that the sale of property there concerned resulted in a capital gain. Bohannon, before December, 1941, was engaged in the real estate business, to wit, the subdividing and selling of real property and the construction of homes. R Corp. was incorporated in January, 1943, to construct and manage a project involving 700 homes in Richmond, Virginia. Bohannon owned 26 shares of the 50 shares of outstanding stock of R Corp. and in May, 1945, R Corp. acquired the other 24 shares. [fol. 17] The 700 houses were completed in August, 1943,

and rented to war workers on a rent-option agreement in form required by the United States. By May, 1947, R Corp. had sold 801 houses, which included re-sale of several houses re-acquired by R. Corp. The houses, constructed primarily for rental, were advertised for rent and were rented for an average of 21 months under the said agreement which restricted the possibility of sale (pg. 265). About May 31, 1947, R Corp. was dissolved.

With respect to the meaning of "primarily", see the court's comments on page 266, as urged by defendant, but also see on this point *Philber Equipment Corp.* v. *Commissioner*, 237 F. 2d 129 at 131 (9th Cir. 1956).

As noted on page 266 of the opinion, the question in the case was whether "the houses were held primarily for sale or primarily for rent." Still on page 266, the court poses and answers a question re the propriety of the imposition of tax as follows:

> "Suppose the taxpayer in the instant case intended to rent the houses for as long as he was required to do so under existing regulations and then to sell them. Or suppose his intention was to pursue whichever of these activities proved to be the most profitable, that is, if the *rental market* were good he would continue to rent but if the *sales market* were high he would sell. In either of these suppositions we think it is fair to say that one of the essential purposes (in acquiring or holding the houses) is the purpose of sale. Under such circumstances, if the taxpayer does dispose of the houses by sale, is it within the legislative *purpose* to allow him to treat the proceeds of these sales as a [fol. 18] capital gain? *We think not.*" (Last emphasis ours.)

Applying the rule to the case at bar, if the taxpayers acquired and were holding the frontage properties with the purpose in mind of developing them for investment or to sell them for profit, depending on which would be

most advantageous, and that by reason of the rezoning and financing problems it was more profitable to sell the properties, then it appears the profits from the sale should not be treated as capital gain under the rule stated by the Court of Appeals, 9th Circuit, in the R Corp. case. This court notes the observation of the Court of Appeals in Philber Equipment Corp., supra, at page 131 of its opinion, where it says, referring to the R Corp. case, that it was one of the numerous war time housing operation cases,

> "* * * where individuals normally in the business of selling houses were required to turn to rental activities due to war time restrictions. Anticipation of selling activities with respect to the rental housing is an important consideration in many of these cases, so that the dual purpose of rental and sale is quite an inseparable factor in determining for what purpose the property is 'primarily' held."

This comment should be considered in interpreting the effect of the R Corp. case on the case at bar but it does not appear that the rule in the R Corp. case with respect to the intent to follow the avenue of greatest profit is not binding on this court.

By reason of

1. The narrow construction rule to be applied in interpreting the statute involved,

[fol. 19] 2. The declared intent of plaintiffs as to the purpose of acquiring and holding the property, that is, if rezoning and financing could not be satisfactorily accomplished, "we would sell the whole thing off in bulk," and

3. The rule as announced by the Court of Appeals, 9th Circuit, in the R Corp. case, supra, quoted hereinabove,

the court concludes that plaintiffs have failed to establish by a preponderance of the evidence that the profits here

involved were held primarily for investment and not for sale in the ordinary course of trade or business. The rift between the partners may have expedited the sale but it appears that the failure to obtain rezoning and satisfactory financing was the primary cause of the sale which was the step intended by the parties to be taken at the time the property was acquired and while it was held, if the rezoning and financing failed. In other words, the property was purchased and held for development *or sale* depending on which course appeared to be most profitable, having in mind the need for rezoning and the availability of proper financing on reasonable terms.

For the foregoing reasons and circumstances, the court concludes that the plaintiffs are entitled to take nothing by their complaint and the defendant is entitled to Judgment for costs.

Counsel for defendant is requested to prepare, serve and lodge proposed Findings of Fact, Conclusions of Law, and Judgment, in accordance with Local Rule 7, as amended. The Judgment shall be a separate document.

[fol. 20] This Memorandum Opinion is not to be deemed a final Judgment.

Dated: March 17, 1964.

E. Avery Crary, United States District Judge.

[File endorsement omitted]

[fol. 21]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue, Defendant.

AMENDMENT TO MEMORANDUM OPINION FILED HEREIN ON MARCH 17, 1964—April 21, 1964

The court's Memorandum Opinion, filed herein on March 17, 1964, is amended by striking therefrom the portion appearing on page 3, line 29, beginning with the words "and at page" to and including line 4, page 4, as not having been read into the record from the deposition of plaintiff Malat at the time of trial.

The comments of the court at the conclusion of the trial should be read having in mind they were made before the court reviewed the evidence and gave full consideration to the points and authorities filed by counsel after the trial.

It appears to the court that the purpose and intent of acquiring and holding the property involved is not altered or determined by the fact a controversy among the parties "triggered" the sale. The purchasing and holding of property with the intent to sell same in bulk if zoning and [fol. 22] financing desired for development cannot be obtained is not, in the opinion of the court, comparable to the purchasing and holding of property with intent to develop, which purpose was frustrated by imposition, a year after

purchase, of a new zoning ordinance by a municipality. *Edwards* v. *Comm.*, 12 T.C.M. 1045, cited by plaintiff.

Dated: April 21, 1964.

E. Avery Crary, United States District Judge.

[File endorsement omitted]

[fol. 23]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC Civil

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue, Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW—Filed April 21, 1964

The above-entitled cause having come on regularly for trial on February 17, 1964, before the Honorable E. Avery Crary, United States District Judge, sitting without a jury; plaintiffs being represented by George T. Altman, Esquire; defendant being represented by Francis C. Whelan, Esquire, United States Attorney for the Southern District of California, Loyal E. Keir, Esquire, Assistant United States Attorney, Chief, Tax Section, with James S. Bay, Esquire, Assistant United States Attorney, personally appearing; and the Court, having considered the pleadings, briefs and evidence, both oral and documentary, and having rendered its memorandum opinion, now finds as follows:

Findings of Fact

1. This is an action for refund of Internal Revenue taxes, which action arises under Title 26 U.S.C., Section 7422 and Title 28 U.S.C., Section 1340.

2. Plaintiffs, William Malat and Ethel Malat, are and [fol. 24] were during the material periods pertinent hereto, citizens of the United States and residents of the County of Los Angeles in the Central Division of the Southern District of California.

3. Plaintiffs, as husband and wife, timely filed their joint Federal income tax return for the taxable year 1956 with the District Director of Internal Revenue at Los Angeles, California, and paid taxes shown on the said return in the amount of $42,341.47.

4. On December 18, 1959, plaintiffs were assessed a deficiency in Federal income tax for the taxable year 1956 in the amount of $4,905.61 together with interest thereon. On February 17, 1960, plaintiffs paid said deficiency assessment plus interest, or a total of $5,531.41. On June 8, 1961, plaintiffs duly filed a timely claim for refund of a portion of the aforesaid deficiency, the refund so claimed being $1,231.22. Said claim for refund was disallowed by statutory mail notice sent on July 12, 1962. On March 5, 1963, within two years after said disallowance, plaintiffs timely filed their complaint herein for refund of tax in the amount of $1,231.22 (the amount of their claim which had been disallowed), together with interest thereon.

5. Plaintiff William Malat was, at all times pertinent to this case, a general partner of Louis Lesser Enterprises, Ltd., a partnership (hereinafter referred to as "Lesser").

6. On August 12, 1953, Lesser and four individuals—Maxwell J. Fenmore, Carl N. Hicks, Sidney Rogen, and Herman C. Millman (each of said individuals hereinafter referred to by his respective last name)—organized Cen-

tury Crenshaw Plaza, a joint venture (hereinafter referred to as "Plaza"). Each member of Plaza had a twenty percent interest in capital and profits and losses. The original contributions to Plaza by its members consisted of cash.

7. This case presents the question as to whether gains from the sales during 1954 by Plaza of certain real property [fol. 25] constituted ordinary income or capital gain. The plaintiffs contend that the subject property constituted "capital assets" as defined in Section 1221 of the Internal Revenue Code of 1954. The defendant contends that the subject property was excluded under Section 1221(1) from the term "capital assets" for the reason that it was property held "primarily for sale to customers in the ordinary course of trade or business."

8. Prior to the organization of Plaza, Lesser and the other members of Plaza had negotiated for the acquisition of a 44.901 acre parcel of real estate known as Timothy-Riordan Ranch, located at Century and Crenshaw Boulevards, Inglewood, California. On or about August 12, 1953, Plaza opened an escrow for the purchase of said property for the sum of $486,000.00. On February 15, 1954, the escrow was closed upon the acquisition by Plaza of the said property.

9. The entire 44.901 acre parcel was fronted on the north by Century Boulevard and on the east by Crenshaw Boulevard, but it did not include the approximate 600 feet by 600 feet parcel at the southwest corner of the intersection of Century and Crenshaw Boulevards. The excepted corner parcel was retained by the sellers of the 44.901 acre parcel.

10. Prior to the date on which the escrow opened for the acquisition by Plaza of the said property, the entire 44.901 acres, together with the corner retained by the sellers, was zoned for agricultural purposes as "A-1". Among the several conditions precedent to the closing of the escrow were two related to zoning. One such condition was that the

44.901 acre parcel be rezoned from "A-1" to multiple residential "R-3"; the other such condition was that the corner lot retained by the sellers be rezoned from "A-1" to commercial "C-2". Both zoning changes were effected prior to the escrow closing on February 15, 1954.

[fol. 26] 11. The members of Plaza, as of the date the 44.901 acres were acquired, intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable. The venturers realized that they had made a good purchase price-wise and, if they were unable to obtain acceptable construction financing or rezoning from "R-3" to "C-2" which would be prerequisite to commercial development, they would sell the property in bulk so they wouldn't get hurt. The purpose of either selling or developing the property continued during the period in which Plaza held the property.

12. One of the possibilities for developing the property was a multiple residential project on the entire property. However, such a project was contingent upon the obtaining of financial guarantees by the Federal Housing Administration, which guarantees could not be secured on terms acceptable to the Plaza venturers.

13. The members of Plaza also gave some consideration to the development of the frontage property along Century and Crenshaw Boulevards, respectively, commercially and the remainder of the property into a multiple residential project. However, the venturers were unable to obtain conventional financing necessary to build apartments upon terms which would make such construction possible. In addition, they could not secure a zoning change from "R-3" to "C-2" with respect to the boulevard frontage property.

14. Plaza subdivided 24.646 acres (hereinafter referred to as "Tract 19705") into 105 lots. It improved the said subdivision by grading, putting in streets and curbs, and installing water and sewage facilities. Tract 19705 constituted the "inner portion" of the property which comprised

in total the 44.901 acres in the sense that the said tract did not itself front either on Century Boulevard or on Crenshaw Boulevard.

15. On April 26, 1954 (approximately two months after the closing of escrow upon the acquisition of the 44.901 [fol. 27] acre parcel) Plaza distributed Tract 19705, subject to liens and encumbrances of record, to the venturers as equal tenants in common. On May 26, 1954, the distributees transferred Tract 19705, subject to said liens and encumbrances, to Century Crenshaw Properties, a joint venture (hereinafter referred to as "Properties"). The members of Properties were Lesser, Rogen, Millman, Espada Properties, Inc., and Hicks Properties, Inc. Fenmore was the controlling stockholder of Espada Properties, Inc., a California corporation, and Hicks was the controlling stockholder of Hicks Properties, Inc., a California corporation. Each member of Properties had a twenty percent interest in capital and profits and losses.

16. Plaza allocated the total cost basis of the 44.901 acres, $486,000.00, to Tract 19705, $266,765.40, and to the frontage parcels retained by Plaza, $219,234.60.

17. Properties sold the 105 lots of Tract 19705 and reported the gains from the sale thereof as ordinary income. The members of Properties likewise reported their distributive shares of the said gains as ordinary income in their respective Federal income tax returns. There is no issue herein with respect to the manner of reporting such gains.

18. Subsequent to the acquisition of the 44.901 acres in February, 1954 and the failure of the members of Plaza to obtain rezoning or acceptable financing, a rift arose among the partners of Plaza with Lesser, Rogen and Millman on one side and Hicks and Fenmore on the other. The rift resulted in acrimony which made further business relations as partners unpleasant.

19. On or about October 15, 1954 (eight months after the acquisition by Plaza of the 44.901 acres), Plaza, out-

of the 20.255 acres retained after the distribution of Tract 19705, sold nine plus acres fronting on Century Boulevard to Hicks-Fenmore Development Company, a partnership, for $123,781.10. The said partnership was comprised of [fol. 28] Hicks, Fenmore and two corporations controlled by Hicks and Fenmore, respectively.

20. On or about November 5, 1954 (within nine months after the acquisition by Plaza of the 44.901 acres), Plaza sold the property then owned by it, being 10.9 acres fronting on Crenshaw Boulevard, to one George Ponty, a real estate developer, for $222,800.00.

21. Gains from the said sales by Plaza of the said 20.255 acres were reported as long-term capital gains for the fiscal years 1955, 1956 and 1957 on the returns of Plaza. Derivatively, the members of Plaza and, in turn, plaintiffs herein, reported such gains as long-term capital gains. The defendant contends that such gains were subject to Federal income tax at ordinary income rates.

Conclusions of Law

And from the foregoing, the Court concludes as follows:

1. The Court has jurisdiction over the subject matter herein and the parties hereto.

2. The statute involved herein, Section 1221 of the Internal Revenue Code of 1954, is a relief provision and must be strictly construed. *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260, 265 (1958); *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46, 52 (1951).

3. Plaintiffs have failed to establish by a preponderance of the evidence that the subject real properties were not held by Plaza primarily for sale to customers in the ordinary course of trade or business. *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 (9th Cir. 1951).

4. The subject real property was held for development or sale, depending upon which course appeared to be most

profitable. *Rollingwood Corp.* v. *Commissioner, supra.* Any rift among the partners may have expedited the sale but did not affect any essential primary purpose for which [fol. 29] the property was held.

5. Plaintiffs herein were not entitled to report the subject gains as from the sale of capital assets but should have reported such gains as ordinary income.

Judgment shall be entered accordingly.

Dated: This 21 day of April, 1964.

E. Avery Crary, United States District Judge.

[File endorsement omitted]

[fol. 31]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC Civil

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

v.

ROBERT A. RIDDELL, District Director of Internal Revenue, Defendant.

JUDGMENT—April 21, 1964

The above-entitled cause having come on regularly for trial on February 17, 1964, before the Honorable E. Avery Crary, United States District Judge, sitting without a jury; plaintiffs being represented by George T. Altman, Esquire; defendant being represented by Francis C. Whelan, Esquire, United States Attorney for the Southern District

of California, Loyal E. Keir, Esquire, Assistant United States Attorney, Chief, Tax Section, with James S. Bay, Esquire, Assistant United States Attorney, personally appearing; and the Court having considered the pleadings, briefs and evidence, both oral and documentary, and having made its Findings of Fact and Conclusions of Law,

It Is Hereby Adjudged and Decreed that plaintiffs take nothing; that their complaint be dismissed with prejudice; [fol. 32] and that the defendant have his costs of suit herein, taxed at $92.01.

Dated: This 21st day of April, 1964.

E. Avery Crary; United States District Judge.

[File endorsement omitted]

[fol. 35]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC

[Title omitted]

NOTICE OF APPEAL—Filed May 7, 1964

Notice is hereby given that William Malat and Ethel Malat, plaintiffs above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the Final Judgment entered in this action on April 21, 1964.

George T. Altman, Attorney for Appellants, 424 South Beverly Drive, Beverly Hills, California. Beverly Drive, Beverly Hills, California.

[File endorsement omitted]

[fol. 36]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC

[Title omitted]

DESIGNATION OF CONTENTS OF RECORD ON APPEAL—
Filed May 7, 1964

To the Clerk of the District Court of the United States for the Southern District of California, Central Division:

Plaintiffs on appeal designate that the entire original record in this Court, shall constitute the record on appeal herein, and request that it be transmitted to the United States Court of Appeals for the Ninth Circuit, in connection with the Notice of Appeal heretofore filed herein.

George T. Altman, Attorney for Appellants, William Malat and Ethel Malat, 424 South Beverly Drive, Beverly Hills, California.

[File endorsement omitted]

[fol. 44]

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 19,286

WILLIAM MALAT and ETHEL MALAT, Appellants,

—vs.—

ROBERT A. RIDDELL, District Director of Internal Revenue, Appellee.

OPINION—May 27, 1965

On Appeal from the United States District Court for the Southern District of California, Central Division

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Before: Merrill, Duniway and Ely, Circuit Judges

MERRILL, Circuit Judge:

Profit derived from sales of property held by a taxpayer, primarily for sale to customers in the ordinary course of his trade or business, is, under section 1221 of the Internal Revenue Code of 1954,[1] excluded from treatment as capital gain.

This case presents the question whether real estate sold at a profit by one engaged in the business of dealing in

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[1] Section 1221, Internal Revenue Code of 1954, reads:

"Sec. 1221. Capital asset defined.

For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; * * *."

real estate had, under the particular circumstances, been held by him as an investment or primarily for sale to customers. Upon this issue the trial court has found against [fol. 45] the taxpayer, ruling that the profit must accordingly be treated as ordinary income. We conclude that the District Court's finding is not clearly erroneous and affirm.

The case involves income tax for the year 1956. The taxpayer[2] had reported the gain on the transaction in question as capital gain. The Internal Revenue Service disagreed. A deficiency was assessed and was paid by the taxpayer. This suit for recovery followed.

Taxpayer at all times pertinent to this case was a member of Louis Lesser Enterprises, Ltd., a partnership (to which we shall refer as "Lesser"), which for some time as a business enterprise had been engaged in the purchase and development of real estate for rental.

In 1953 Lesser and four individuals not members of the partnership negotiated for the purchase of 44.901 acres of agricultural land, located at Century and Crenshaw boulevards in Inglewood, California. On August 12, 1953, they organized Century-Crenshaw Plaza as a joint venture, entered into agreement for purchase of the property for the sum of $486,000 and established an escrow for that purpose. At the time of the establishment of the escrow the land was zoned agricultural. A condition to the closing of the escrow was that it be rezoned as residential, and that a corner parcel retained by the seller, 600 x 600 feet, be rezoned as commercial. These changes in zoning were accomplished and the escrow was closed on February 15, 1954.

In the meantime the intentions of the venturers with respect to the land had undergone a series of changes.

At the outset, as taxpayer testified, they "had in mind" a garden-type apartment development of the entire property —a single-mortgage development, requiring no division of

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[2] William Malat is referred to as the taxpayer. His wife is joined since a joint return was filed.

the property into separate parcels. This was contingent not only on their securing zoning changes (in which they were successful) but (since they were themselves in no position to finance the project) also on their ability to secure adequate financing. In this respect they first sought the assistance of the Federal Housing Administration but [fol. 46] found that they could not secure FHA guarantees on terms acceptable to them. They next sought conventional financing. Their efforts, through mortgage brokers and savings and loan associations, failed. As taxpayer testified, "The mortgage market was very, very soft then, very tight." They then abandoned their original idea of a single-mortgage project. Taxpayer testified: "Our next thought was to build individual apartments, 4-, 6-, 8-unit buildings and finance each one with a separate mortgage." This involved carving out an inner parcel of 20 to 25 acres for the apartment buildings and retaining the two frontage areas on Century and Crenshaw boulevards for commercial use. A subdivision map covering the inner parcel was presented to the City of Inglewood and approved. For two reasons, this idea also had to be abandoned. The rezoning of the frontages could not be secured. Also, despite all efforts, the venturers were still unable to secure financing.

They were now faced with interest charges on their trust deed and with the cost of street improvements and like subdivision expenses. Taxpayer testified "So we took the next best route, * * * and proceeded to sell the lots, the individual lots in the subdivision." The frontage parcels were retained, still in hope that commercial zoning could be secured as to them. The prospects of rezoning remained discouraging and a rift developed among the venturers: Lesser and two individuals "wanted to get out and be done with it." The other two wished to hold on. Eventually those who wished to get out, including Lesser, sold out their interests.

The gain which the venturers had realized on sale of the subdivision lots had been reported as ordinary income and

is not here involved. Our sole concern is with the gain realized on the sale of the two frontage parcels.

Taxpayer contends that at no time had the venturers ever contemplated sale of these parcels until the rift among them brought about a change of plans; that at all times these parcels had been held for future development for the production of income; that when the subdivided lots had been sold the frontages were withheld from sale pursuant to original intent.

The Government contends that the prospect of sale was present from the outset, and constituted a primary purpose [fol. 47] of the holding at the time of the sale. It points to the following testimony of taxpayer:

> "Q: Mr. Malat, at the time that you were considering the zoning potential and the development potential of this property, did you contemplate, in acquiring the property, the possibility that rezoning or refinancing, or whatever, might not be possible?
>
> A: This is always a possibility in real estate development.
>
> Q: And what was your intention if that couldn't—I mean, you must have considered this as well.
>
> A: Well, this was a bridge that we all felt we would cross when we came to it. We would first do the things—we felt that we had made a good buy on the property as far as price is concerned, so that if we couldn't do anything in the way of zoning, we would sell the whole thing off in bulk. We wouldn't get hurt. So, there was no urgency. There was no need to say, 'Well, if this doesn't happen, and that doesn't happen—' we took one step at a time."

The District Court, in its memorandum opinion, stated:

> "It appears from the testimony of plaintiff read into evidence from his deposition, referred to above, that the property here in question was purchased with the thought in mind that if the rezoning or appropriate financing could not be accomplished that the parties

'would sell the whole thing off in bulk. We wouldn't get hurt.'"

And further:

"The rift between the partners may have expedited the sale but it appears that the failure to obtain rezoning and satisfactory financing was the primary cause of the sale which was the step intended by the parties to be taken at the time the property was acquired and while it was held, if the rezoning and financing failed. In other words, the property was purchased and held for development *or sale* depending on which course appeared to be most profitable, having in mind the need for rezoning and the availability of proper financing on reasonable terms."

The court concluded that at the time of sale of the frontages the properties were held with a dual purpose; that sale [fol. 48] of the properties was an essential purpose. Relying on *Rollingwood Corporation v. Commissioner,* 190 F.2d 263 (9th Cir. 1951), it held taxpayer not entitled to capital-gain treatment.

Taxpayer seeks to distinguish *Rollingwood* on the ground that there the dual purpose was clearly fixed in a lease-or-option arrangement to which taxpayer was committed. Here, he asserts, the only "dual purpose" lies in his recognition, wholly consistent with investment, that sale might ultimately be felt to be more desirable financially than a continued holding for investment. Cf., *Municipal Bond Co. v. Commissioner,* 33 U.S.L.Week 2465 (8th Cir. 1965).

We quite agree with taxpayer that an investor's prospective recognition of the fact that he may ultimately wish to realize on his investment is not enough to constitute sale a dual purpose of the holding. *Rollingwood* does not require such a result. We cannot agree with taxpayer, however, that this is such a case.

In such a case as this the purpose of the holding is undoubtedly difficult of ascertainment. Where an investment

program has been followed through, it is there for all to see. Where it has been frustrated at the outset and resort is had to sale, the purpose of the holding at the time of sale is far more questionable. Was the sale a liquidation of an investment whose prospects had proved disappointing? To put the question another way, was it the exercise of a purpose *not* to hold rather than of a purpose to hold for sale?

In our judgment the answer in such a case must be found in the scope of the gain-producing purpose for which the property was acquired and held. Two situations may be hypothesized to illustrate what we mean.

(1) If the purpose for which the property was acquired and held was solely and specifically to develop for rental; if it excluded the realization of gain other than in that fashion; and if such purpose was accompanied by an intent to liquidate (irrespective of consequent gain or loss) if this purpose failed, then a sale pursuant to such a program might well be regarded as nothing more than liquidation of a disappointing investment.

(2) If, however, the property was acquired and held with the purpose of realizing gain from it in any feasible [fol. 49] manner which might present itself; if the owner stood ready to adapt his program to such changes as failing prospects might require and to realize gain wherever and however he could; then surely the realization of gain by sale is pursuant to the purpose of the holding. The taxpayer in such a case could be said throughout the course of his holding to have had several alternative purposes (all of which were substantial reasons for his holding within the *Rollingwood* definition of "primary"), each of which in turn actually became the primary purpose as efforts were concentrated in its direction.

The nature and extent of the gain-producing purpose is, of course, a factual issue. Whether in a particular case it falls on the investment-limited side of the line or on the all-encompassing side is a question of fact.

The District Court in substance has found that the scope of the taxpayer's intent was all-encompassing.[3] In our judgment the record amply supports that finding.

In this connection we note first that it must be recognized that in the case of one who deals generally in real estate the rational inference is that the purpose of the holding was all-encompassing. The dealer is, after all, in the business of acting in precisely that fashion. Where an avowed purpose to invest (rather than hold for sale) has failed to materialize, the real estate dealer thus has a burden to meet in overcoming the inference that upon failure of the investment prospect the property sold had thereafter been held primarily for sale to customers in the ordinary course of his trade or business. See *Margolis v. Commissioner*, 337 F.2d 1001 (9th Cir. 1964).

While the nature of taxpayer's business was primarily that of development of real estate for rental, and he might therefore dispute the rationality of such an inference in [fol. 50] this case,[4] still, the history of his holding provides ample support for the court's finding. That history demonstrates the many possibilities of gain possessed by the property (including subdivision and sale) which were in turn explored by the owners. At the outset taxpayer realized that the original plan might not work out. He would, he testified, cross that bridge when he came to it—take one step at a time.

Certainly it may be said (as the District Court in effect has said) that the purpose of the acquisition encompassed all of the steps which were successively taken, and that the primary purpose of the holding touched on each in turn.

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[3] The District Court has found as fact that "The members of Plaza, as of the date the 44.901 acres were acquired, intended either to sell the property or develop it for rental, depending upon which course appeared to be the most profitable."

[4] It does not appear that the nature of the business of the joint venture, or of the venturers with whom taxpayer was there associated, was so limited. The inference may thus still retain its rationality as to this particular venture of the taxpayer.

Sale, then, was not the liquidation of an investment. It was the final alternative in taxpayer's continuing efforts to realize gain from his acquisition. It was *part* of his plan rather than the abandonment of it.

Under these circumstances, when taxpayer resolved to sell, that purpose (which from the time of acquisition had been one of many alternative essential purposes) became the primary purpose and the property was primarily held for the purpose of sale.

Judgment affirmed.

[fol. 51]

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 19,286

WILLIAM MALAT and ETHEL MALAT, Appellants,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue, Appellee.

JUDGMENT—May 27, 1965

Appeal from the United States District Court for the Southern District of California, Central Division.

This Cause came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California, Central Division, and was duly submitted.

On Consideration Whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

Filed and entered May 27, 1965

[fol. 52] Clerk's certificate to foregoing transcript (omitted in printing).

[fol. 53]

SUPREME COURT OF THE UNITED STATES

No. 487, October Term, 1965

WILLIAM MALAT, et ux., Petitioners,

v.

ROBERT A. RIDDELL, District Director of Internal Revenue.

ORDER ALLOWING CERTIORARI—November 8, 1965

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. A]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

Honorable E. Avery Crary, Judge Presiding

No. 63-169-EC

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue, Defendant.

Reporter's Transcript of Proceedings—February 17, 1964

[fol. B] APPEARANCES:

For the Plaintiffs: George T. Altman, 424 South Beverly Drive, Beverly Hills, California.

For the Defendant: Francis C. Whelan, United States Attorney, By: James S. Bay, Assistant United States Attorney, 808 Federal Building, Los Angeles, California.

[fol. 4]

Los Angeles, California, Monday, February 17, 1964.
2:10 P.M.

* * * * * * *

Excerpts From Opening Statement on Behalf of the Plaintiffs

* * * * * * *

[fol. 8] Mr. Altman: Now, one more thing is a matter of fact, and I have been advised now by defendant that the claim, the corresponding claim of Mr. Millman has been

allowed, was allowed, and that this occurred, and this occurred after the dismissal in the prior proceeding which was brought by Mr. Fenmore on his corresponding claim.

Now, may I have the statement of defendant at this point so I will know as a part of the record?

Mr. Bay: That claim was allowed.

The Court: The claim of Mr. Millman was allowed?

Mr. Bay: Yes, sir.

The Court: I don't know what the claim of Mr. Millman was offhand. What was Millman's claim, that it was a long-term capital gain?

Mr. Bay: Yes.

Mr. Altman: It was precisely the corresponding claim. As I say, this occurred after the dismissal in Fenmore's proceedings.

The Court: Do you agree?

Mr. Bay: Your Honor, the claim was that the transaction in question here gave rise as to Millman to a long-term capital gain, and this claim was allowed.

The Court: Well, how does it affect this case?

Mr. Bay: Not at all, your Honor.

* * * * * * * *

[fol. 18] WILLIAM MALAT, a plaintiff herein, called as a witness on behalf of the plaintiffs, having been first duly sworn, was examined and testified as follows:

* * * * * * *

Direct Examination.

By Mr. Altman:

Q. Mr. Malat, are you and your wife the plaintiffs in this proceeding?

A. We are.

Q. Will you state what your business is—what your business was in 1954 and 1955?

A. Development of real estate for investments.

Q. Was this on your own behalf alone or as a member of any partnership?

A. I was a member of two partnerships at that time that were so engaged, Louis Lesser Enterprises, Ltd., and Lesser Industrial Properties, Ltd. I was a general partner in both of those partnerships.

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[fol. 19] Q. Referring again to the years 1954 and 1955, what was the business of Lesser Industrial Properties?

A. The construction for lease to industrial firms of warehouses and factories and similar facilities. We had a number of buildings that we owned and were leasing on a fairly long-term basis to such companies.

Q. Were you holding these properties only for lease or also for sale?

A. Only for lease.

Q. Now, how about Louis Lesser Enterprises, Ltd., what business was it in at that time?

A. It was in the different phases of real estate development. It owned interests by virtue of a 50 per cent stock ownership of a corporation in which there was only one other stockholder. We were sort of partners with a gentleman named Irwin Kahn for the construction and retention for leasing purposes of over 300 duplex buildings in the San Diego area, apartments, but two apartments to a building. We still own those same buildings now.

We also had an interest in the shopping center deal—[fol. 20] two shopping center deals in San Diego—the Clairemont area in San Diego.

Q. Were you holding that for income?

A. Yes. We also owned interests in Wherry—W-h-e-r-r-y—Wherry Housing Projects. This is a rental housing for military personnel at military installations. I would say it is Government military installations. Those are rental projects.

We owned land, various areas of Los Angeles and Orange Counties.

Q. For what purpose was the land acquired?

A. Acquired for development, construction of different

types of buildings, single-family residences, apartments, commercial shopping centers.

Q. Did you hold any of such land for sale as such?

A. No, not acquired for that purpose. None of the land we owned then was acquired to hold it and sell it.

Q. Acquired, you say, only to develop?

A. It was acquired to develop.

Q. Were you also interested in any partnerships which held properties for sale to customers?

A. Yes.

Q. What type of properties were those?

A. Well, those were what we call R-1 properties, where unimproved land is bought and subdivided, subdivision [fol. 21] improvements installed, single-family residences are constructed and then sold to customers under VA financing or FHA financing or conventional financing.

Q. Did you hold any office building properties for rental?

A. In '54—I don't believe we had acquired any office buildings at that time.

Q. May I ask you again—I am not sure that I got the answer to this—whether you as an individual, separate from these two partnerships, whether you were active in real estate?

A. Yes, I had some personal interests. I had a small interest in a shopping center in Lakewood.

Q. Was this held for income purposes?

A. Yes. And I was personally an investor in some housing deals, single-family housing deals, the R-1 type where you build single-family residences.

Q. I mean individually.

A. As an individual, yes.

Q. I see.

A. Not on any scale compared to the partnership operations.

Q. Did you yourself ever hold any raw land for sale to customers?

A. No.

[fol. 22] Q. Never did?

A. No.

The Court: When you say "raw land" you mean undeveloped land?

Mr. Altman: Undeveloped land.

The Court: All right.

By Mr. Altman:

Q. Now, Mr. Malet,—

The Court: Another thing, Mr. Altman, that I am not quite sure about. You say, "Did you ever hold any raw land for customers?" Do you mean by that that he never held real estate for resale? Is that what you mean? That it was all held for investment?

The Witness: No, sir, I—

The Court: What did you mean, "raw land for customers"?

The Witness: I never bought or had an interest individually in a parcel of land that was bought with the intention of reselling it in that state.

The Court: I see.

The Witness: I was an investor in deals where—

The Court: You bought it to develop it for lease and so forth,—

The Witness: Right.

The Court: —and for resale as well as lease?

[fol. 23] The Witness: Resale after houses were built on it.

The Court: After development.

The Witness: After development, yes.

The Court: All right. I understand.

* * * * * * *

[fol. 32] By Mr. Altman:

Q. Mr. Malat, coming now to this partnership of Century-Crenshaw Properties—I mean Century-Crenshaw Plaza, can you state how it got started?

A. Yes. Sometime in 1953, I believe it was, we were approached by Mr. Sidney Rogen and a Mr. Herman Millman. Mr. Millman was known to us through our previous activity in the manufacturing business and he was in a related industry at that time, at an earlier date. Mr. Rogen was known to us because we were associated with Mr. Rogen in another deal.

They told us that they had been trying to acquire a piece of property at Century and Crenshaw. That their negotiations had broken down with the owner or representative of the owner and they thought possibly we might be successful in being able to buy the property, in which case they would like to be our partners along with Hicks and Fenmore, who also were associated.

The four of them had tried to buy this property and were unsuccessful. They told us the basis on which they thought the property might be able to be purchased and suggested we make an independent fresh contact with the owner or the owner's representative and see if we could tie the property up.

Q. Was there any discussion at that point of what you [fol. 33] would do with that property?

A. Yes. They said that in the light of the early extensive development of the property in that area, a large portion of which had formerly been a part of the L. T. Johnson ranch, a very successful—or two successful 608 deals—that is an FHA title—right up the street—a title that covers apartment development, that both as to its location and size that lent itself to the development into a major apartment project, and that if we could buy the property, if we could get the property for them, get the property financed, that there was a great potential for income spread over a long period of time from such a development in a fast-growing area.

Q. Now, did you proceed then to acquire the property?

A. We contacted a Mr. Robert Chambers, who was a real estate broker, but he was also married to the lady who either owned it—I forget now—or was the heir to the property that we were trying to buy.

After some negotiations with him we were successful in putting the property in escrow and tying it up.

The Court: Now, when you say "we" are you talking about your partners?

The Witness: Yes. At this time I was acting for the partnership of Louis Lesser Enterprises, Ltd., which, in turn, was acting on behalf of these other individuals if we [fol. 34] were able to buy the property.

The Court: All right.

By Mr. Altman:

Q. In other words, this was on behalf of the partnership of Century-Crenshaw Plaza?

A. It was on behalf—

The Court: Louis Lesser Enterprises.

The Witness: —of Louis Lesser Enterprises, which was acting also for these other people, with a view of becoming their partners if we were able to buy the property.

By Mr. Altman:

Q. I see.

The Court: That was Plaza and Fenmore.

The Witness: Fenmore, Hicks, Rogen and Millman.

The Court: Wasn't Plaza in there some place?

The Witness: Well, that was the partnership, those four individuals, and Louis Lesser Enterprises.

By Mr. Altman:

Q. At the time you went into escrow, did you become committed to purchase the property?

A. Yes.

Q. What conditions as to zoning were placed upon the completion of the escrow?

A. Our ability to have the property that we were buying [fol. 35] zoned into R-3, which is zoning that permits the construction of apartments.

And the owner also said, "Well, that is a condition to our selling the property. We want to make a part of it also that we get the corner."

They were holding out a corner, 600 by 600 feet or 650 by 650, something like that, getting that zoned commercial.

Our agreement was that the application for the total zoning, that we would take their application at that time for commercial zoning on the 49 acres or so that we were buying.

Q. Was that a condition of the escrow, that you would make application for commercial on that part of it?

A. I don't know whether it was a condition of the escrow or the—I know it was a condition of the purchase. What document I don't recall at this time, but I know it was a condition.

Q. Was there also a condition in respect to FHA and VA approval?

A. Well, not VA, because VA had nothing to do with the apartment construction, but we were vitally concerned with getting a site approval of FHA.

The Court: Was that a condition of the escrow?

The Witness: I believe it was, to get site approval by [fol. 36] FHA that this property was eligible for mortgage insurance purposes for an apartment development under one of the FHA titles.

By Mr. Altman:

Q. Mr. Malat, what are your duties in connection with Louis Lesser Enterprises and Lesser Industrial Properties? I mean what position were you occupying in those two properties?

A. Well, I was a general partner in the two partnerships. My function was land acquisition, development, generating the financing that was necessary for the development. About every phase of real estate management, in the development of real estate property.

Q. Were you familiar then with all the problems of rezoning?

A. I was familiar with the problem.

Q. Could you state what procedures were ordinarily taken, as a matter of course, prior to actually filing an application for rezoning?

A. Well, then and now and at all times the most practical procedure when you want a property rezoned is to have an informal conference with the planning authorities of the particular—whatever subdivision you are located in, either the County of Los Angeles or an incorporated city.

The procedure of getting rezoning is time-consuming in [fol. 37] the preparation of maps and ownership of lots and all that, and we always like to and still do get an indication from the planning authorities of what their thinking is, both city and county, either a formal master plan or general master plan of how they would like their city developed.

We explored their thinking, because if we are not going to get it we would rather be informally turned down than formally turned down, because a formal turn-down sort of precludes you later from coming back, so we do informal exploration as to the chances of rezoning first.

Q. I see. Now, directing your attention, Mr. Malat, to the period of six months which the exhibits show elapsed between the opening of escrow and the closing of escrow on this purchase by Century-Crenshaw Plaza, would you be able to state why it took six months? Just what took place there in that period?

A. Well, the first thing that had to be determined, which was the most important consideration to us, was getting the property rezoned to R-3, which would permit the construction of apartments, and a formal rezoning takes almost that long to accomplish between the initial getting started and the preparation of the application and the maps that have to accompany it, and then the statutory time lapses between the approval by a planning commission and the approval by a city council, in the case it is a city, and then [fol. 38] the approval of the ordinances and the publication of the zoning ordinances. There are statutory time requirements that take almost the full six months.

Since we weren't interested in buying the property unless we had R-3 zoning—

* * * * * * *

[fol. 42] Q. Mr. Malat, I would like to backtrack again for a moment to Millman and Hicks.

Did Mr. Millman ever come up to your office prior to this deal, the Century-Crenshaw purchase?

A. Yes.

Q. In what connection?

A. Well, he used to come up two or three times a week looking for deals, asking us—he said he was out of the dress business then, and "How about putting me in a deal with you?" He knew we were active in real estate.

Q. Did he refer to any particular kind of real estate deal?

A. Yes, he said he was interested in deals that collect rents, having a continuing income from.

Q. And how about Mr. Hicks, did he ever contact you prior to this Century-Crenshaw deal?

A. Yes.

Q. In what connection?

A. As a real estate broker he submitted various properties to us to try and sell us properties.

Q. Now, again on the history of the financing problem in connection with this Century-Crenshaw development, can you state exactly what occurred beginning with the beginning of the escrow and from then on?

[fol. 43] A. As soon as we tied the property up and had our first informal meeting with the planning authorities of the City of Inglewood and had reasonable assurance we were going to get the zoning we wanted—in other words, the property would be R-3—so we could build apartments on it, we then talked to—I know one fellow named Milton Gordon, who was a mortgage broker, and asked him to explore the possibility of getting mortgage financing for a large apartment, a garden-type apartment development on the property.

What we had in mind then was a Title 608 FHA garden-type apartment, which generally has 20 to 22 units per

acre and a two-story development. With almost 50 acres, this was almost a thousand units.

He had done a lot of this type of financing—not that he had done the financing, but he had acted as a mortgage broker in procuring financing for other brokers.

In about two weeks he reported back to us that the mortgage market was very, very soft then, very tight. There was a scarcity of mortgage money available. That he wasn't very hopeful about being able to interest a lender into making a loan on the type of development we had in mind.

We then ourselves contacted some of the savings and loan associations that we knew in the Los Angeles area [fol. 44] to find out as to their possible interest in doing the conventional type of financing. By "conventional" I mean something that doesn't have a Government mortgage guarantee attached to it, but a conventional type of loan.

Even there there wasn't much interest. We had pretty well ruled out the—after, you know, some more exploratory work we had ruled out the hope of getting project financing on a project basis. We realized that—

Q. What do you mean by "project basis"?

A. Well, if you are building under the old Title 608, the Title 207 which replaced it under FHA, the National Housing Act, a project financing doesn't require subdivision, individual lot subdivision.

If we had been successful in getting a 608 financing at that time, we could have built a thousand units on this—approximately a thousand units on this approximately 50 acres of land without filing a subdivision map.

The Court: You mean on the 44 acres?

The Witness: Or the 44.

The Court: 44.9.

The Witness: Whatever the total acreage was.

608; under the FHA, you can get from 20 to 22 units per acre, and we could have built that entire project without filing a map of individual lots, because it is a one-mortgage deal. One mortgage covers the entire project.

[fol. 45] But when we had pretty well exhausted the possibility of being able to get that kind of financing, our next thought was to build individual apartments, four-, six-, eight-unit buildings, and financing each one with a separate mortgage.

By Mr. Altman:

Q. Would that have required subdivision?

A. That would have required—well, it would have been a more basal way of doing it, with a subdivision. And I think under the Mass Act we would have had to file for subdivision, anyway. Otherwise, you are faced with the necessity of metes and bounds description and you are precluded from putting in dedicated streets that the city will then maintain.

In order to provide an adequate traffic flow on an individual lot basis, you almost have to go to a subdivision.

We felt that was the next most logical step, because then we wouldn't be dependent on just one lender for the entire project. We could finance, like, three buildings with one lender and two with another and six with another. Because once we had the property subdivided into individual lots we could build our apartment buildings progressively one or two at a time and bounce from one lender to another if necessary. But even that market was too rough. We [fol. 46] just—

Q. Well, what was your intention in that connection, to build for retention for income purposes or for sale?

A. To build apartments—

Mr. Bay: Objection, your Honor. These questions constantly coming up about intention to build for income purposes or for sale calls for a conclusion.

By Mr. Altman:

Q. Well, what was your intention in connection with this financing, where you considered taking them in units instead of the entire property as one property?

A. Well, our objective was the same on an individual building basis, as it was on a project basis, was to develop the property into apartments, apartment buildings that we could keep and collect rents on.

Q. And again what happened to the financing prospects on that end of it?

A. We were pretty consistently turned down by every savings and loan association we approached. We contacted a couple of insurance company representatives, correspondents, and we talked to Western Mortgage Company which represents the Metropolitan Life Insurance Company.

I talked to a fellow named John Sullivan, who was with the Thomas Mortgage at the time, and they weren't very encouraging. As a matter of fact, they were pretty dis-
[fol. 47] couraging about their chances of getting any mortgage financing for us from insurance companies.

Q. Did you investigate C-2 rezoning to any extent at this time?

A. Not during the early escrow period, because we couldn't. It was the condition of our purchase with Mr. Chambers that the zoning application that went in would be for K-2 only on the corner, which was being retained by the seller, and R-3 on the property that surrounded the corner that we were buying. So we couldn't go after C-2 zoning until we owned it.

Q. After this period in which you said that your second plan for financing fell through, what did you do then?

A. Well, we—there was sort of an intermediate period there. Once we determined it just wasn't feasible to consider a project development, in other words, a total project without a subdivision and all that, we pretty well resigned ourselves to the fact the only hope we had of developing this property with apartments would be on a single-building basis depending on the size lot, four units or six units or eight units to a lot.

So we carved out a piece of around 20, 25 acres—I forget exactly how much of the interior portion—leaving the two frontage pieces apart and prepared a subdivision map on

[fol. 48] that and submitted that to the City of Inglewood almost concurrently with the zoning application or shortly after the zoning application, and asked them in considering the request for rezoning to also consider the subdivision map.

The Court: This was before the escrow closed?

The Witness: Yes, sir. So that if the zoning were approved, then at least we could proceed to try to build buildings and finance them on an individual building basis and we would then have a subdivision on which we could do this. We would have access streets off of the two perimeter streets, Crenshaw and Century, and the internal streets for traffic flow and then go ahead and try to develop the project with individual apartment buildings.

By Mr. Altman:

Q. Did any changes take place, after the escrow closed, in your plans or in the prospects?

A. Well, the only change was it got worse. We couldn't get any mortgage financing to go ahead with the building program. We were now faced with the dividends and mortgage payments on the purchase trust deed, the interest and the necessity of putting in the improvements, the street improvements, and all that.

So we took the next best route, in the light of our inability to get mortgage financing, and proceeded to sell the lots, the individual lots in the subdivision.

[fol. 49] Q. Mr. Malat, can you state the reason for the agreement of April 1954, represented in Plaintiffs' Exhibit 9, the reason for the amendment of the original trust deed which took place at that time?

A. Yes. When it became apparent to us that our hope of building apartment buildings and getting adequate mortgage financing to do so was a dim hope, and that in order to bail out of this deal we were going to have to sell the lots, the original trust deed that we gave the seller as part of the security—as security for part of the purchase price

on the purchase money note, provided for no release clauses on an individual lot basis, and we went back to Mr. Chambers and asked him if he could get the holder of the deed of trust to amend it so we could release individual lots, and agreed upon a release price, so that then we could sell them and deliver the titles to the lots without the encumbrance of this deed of trust.

Q. Referring to Exhibit No. 5—no, Exhibit No. 10, the partnership agreement in respect to the Properties Company, Crenshaw Properties Company, dated May 26, 1954, I will ask you if there is any relation between that agreement and this change in the trust deed.

A. Well, yes, to this extent—well, the answer is yes, there was a relation. We wanted to be able to deliver the lots in the subdivision. There were 105 lots in the subdivision. [fol. 50] But we still had some hopes that we might be able to get some sort of commercial zoning on the two frontage parcels, the parcels that fronted on Crenshaw and Century, which were two major arteries in the Inglewood area.

So we figured if we could get a release provision on the 105 lots that would enable us to sell those and deliver title free of the encumbrance of this deed of trust to the seller, and then retain these other two parcels and try to get commercial zoning on them.

Q. I see. Now, referring to those other two parcels, what procedure, if any, did you take in connection with them?

A. Well, we wanted to try to get them rezoned commercially. Our office at that time was at 141 El Camino in Beverly Hills, and Mr. Fenmore's office was in the same building, one floor below us, so we saw each other frequently and discussed it, and I told Max, I said, "Max,—" that is Maxwell Fenmore. I said, "Max, if we can get these two properties zoned commercial, the two frontage pieces on Crenshaw and Century," I said, "they can become very valuable pieces. We could proceed to build stores, commercial properties, and we have got a fine property here."

He says, "Bill, forget it. You are not going to get them

zoned commercially. The City of Inglewood isn't going to go along with that kind of zoning."

[fol. 51] I said, "Well, let's try."

He said, "I have already talked to Ken Johansen down there—" who was on the City Engineering or Planning Department "—and he has told me."

I says, "Well, make a date. Let's you and I go down and talk to him," which we did.

Mr. Fenmore and I went down to the City Hall in Inglewood and met with Mr. Johansen, and I asked him what the chances were of getting commercial zoning on both or either of the two frontage parcels, the piece on Crenshaw and the piece on Century.

He said, "You have no chance." He said, "Don't waste your time with an application." He said, "I will tell you now it will be turned down. You will not get commercial zoning on those properties."

Q. Do you have any idea as to how long after this new partnership of Century-Crenshaw Properties was formed that you did this? Is there any relation in time that you can recall?

A. Almost immediately.

Q. I see. In regard to these two frontages, Mr. Malat, were they ever advertised by Plaza, the partnership?

A. No.

Q. Were they ever listed with any brokers?

A. No.

[fol. 52] Q. Did you ever have any signs on them?

A. No.

Q. Did you solicit any offers for them in any other way?

A. We did not.

* * * * * * *

[fol. 53] Q. In the regular course of the business of Plaza were there any plans to hold these two parcels, these frontages, for sale to customers in the regular course of business of Plaza, the partnership?

A. No, there were no such plans.

Q. Did Louis Lesser Enterprises, Ltd., in connection with its own business, have any such plans?

[fol. 54] A. Well, in connection with the business of Louis Lesser Enterprises, Ltd., these two properties—we were a partner in the Plaza and Properties partnerships, and as a general partner and with some voice in management we had no plans to sell these two parcels of land.

* * * * * * *

Q. Mr. Malat, can you explain how it happened that these two parcels were, in fact, sold?

A. Yes.

The Court: You are talking about the two front parcels?

Mr. Altman: The two frontages, yes.

The Court: All right.. Go ahead.

The Witness: Although our office was in the same build-

[fol. 55] ing as Mr. Fenmore's and we spoke to him frequently about the Century-Crenshaw properties, our relationship with him as a partner in these properties wasn't of the best. There was a fairly strong serious rift among the partners.

By Mr. Altman:

Q. When?

A. In point of time, the middle of 1954 there developed this rift and it resulted in sort of two factions within the partnership, on the one hand Hicks and Fenmore, and on the other Millman, Rogen and ourselves, who were Lesser Enterprises.

Even when I suggested to Fenmore the possibility of getting the two frontage properties zoned commercially, he told me, "Forget it. You won't do it."

We met with Mr. Johansen and Mr. Johansen told us we couldn't get the zoning and we were reaching the frame of mind of just wanting to get out and be done with it, to wind up the affairs of the partnership, and I for one, as Louis Lesser Enterprises, had no further interest in any further business associations with Mr. Fenmore or Hr. Hicks.

Mr. Hicks came to one of the meetings of the partners and said, "Look," he said, "we are getting nowheres. We have got these two properties on our hands," the two frontages.

He said, "You have been turned down by the City of [fol. 56] Inglewood on the zoning. I will buy the Century frontage from you."

And we said, "Make us an offer and let's see what it looks like," and he did.

He submitted an offer to the partnership. There was a lack of unanimity between myself personally and my other partner—one of our other partners in Louis Lesser Enterprises, who was Louis Lesser, he wanted to hold onto it, he didn't want to make the sale.

He said, "This property—we may not get a rezone now. The time will come. It rests on a major boulevard and it eventually must be commercial. We can just sit with it if necessary. We are not going to let Hicks steal it."

Millman and Rogen wanted out, they wanted to wind up the affairs of the partnership and get rid of the many assets and get done with it. They, too, and I persuaded Lou to go along and we accepted Hicks' offer for the purchase of the Century frontage.

The Court: He bought one parcel?

The Witness: Yes, sir.

* * * * * * *

[fol. 59] Mr. Bay: Your Honor, the defendant is willing to stipulate Hicks made a purchase on or about October 15th, as stipulated to by counsel, on behalf of Hicks-Fenmore Development.

Mr. Altman: Your Honor, this is not adequate because I do want to show the date. My purpose is to show the exact date, your Honor.

The Court: "On or about October 15,—" the stipulation is "—Plaza, out of said 20.255 acres . . . sold 9 plus acres, [fol. 60] fronting on Century Boulevard, to Hicks-Fenmore Development Company".

Now, you have stipulated to that.

* * * * * * *

[fol. 64] By Mr. Altman:

Q. May I ask you this, Mr. Malat: In regard to this escrow statement, which is Exhibit 13 in evidence, and referring to a purchase money deed of trust and a payment of money, can you tell me whether—what relation to the [fol. 65] closing date of escrow those were paid into the escrow?

A. They were paid in the day before this date. This was the date of the recordation of the grant deed and the money came into escrow the day before.

Q. Was that also true of the trust deed?

A. Yes.

* * * * * * *

[fol. 76] Q. What was the situation between the partners, between these two groups of partners, at the time of the sale?

* * * * * * *

The Witness: During the months of August, September, October and November 1954, I believe it was, there were no less than ten meetings of the partners held; most of them in the office of Mr. Fenmore. The purpose of these meetings was to discuss the charges and countercharges made by—

The Court: What was said? Who charged anybody?

You see, when you say there were charges and countercharges, that is your conclusion. You will have to tell me what was said, the best you can recall. Nobody expects you to remember the exact words, but in substance. When you first got together you say it was in August. Were you in controversy in August?

The Witness: We were in controversy in August, yes, [fol. 77] sir.

The Court: When you had this meeting in August, who was present, Fenmore—

The Witness: Mr. Fenmore, Mr. Hicks, Mr. Rogen, Mr. Millman, and I was there and Louis Lesser was at some of the meetings that took place.

The Court: What was said and by whom? Did somebody accuse somebody of doing something wrong?

The Witness: There were two factions. First of all, we chose up sides, so to speak, with, on the one hand, Fenmore and Hicks, and on the other there was Rogen, Millman and myself representing Louis Lesser Enterprises.

We Charged Mr. Rogen—Mr. Fenmore and Mr. Hicks with not acting for the best interests of the partnership. We felt that they didn't—that Hicks was getting kickbacks in commissions on the sale of the lots in the subdivision and that Fenmore was trying to exact unwarranted compensation from the partnerships for services we didn't feel he had rendered as a partner.

We were not happy with the relationship and we would like to wind it up as quickly as we could.

By Mr. Altman:

Q. Did Mr. Fenmore make any representations as to the possibility of C-2 zoning?

A. He told me emphatically it was impossible to get either [fol. 78] the Crenshaw or the Century frontage zoned.

The Court: When did he tell you this?

The Witness: July or August of—it was in the fall or late summer of '54.

The Court: Did that have anything to do with your winding up the proposition, because you couldn't get C-2 zoning?

The Witness: Yes, it did.

The Court: That was part of the reason for winding up your partnership?

The Witness: Yes, sir.

The Court: That wasn't anybody's fault, was it? That wasn't any fault of Fenmore or Hicks, that you couldn't get C-2 zoning, was it?

The Witness: I say yes, it was, in my opinion, because I later found out it was possible to get the zoning and he was misleading us.

The Court: All right. Now we are back in August. I am trying to get this down, if I can get it. It will probably help your side of it, but I would like to get it as fast as we can.

What did they say when you accused them of this, when you made these statements you just related? What did Hicks or Fenmore say? This was in August, as I understand it.

The Witness: Yes. Fenmore denied having received any [fol. 79] kickbacks on the commissions.

The Court: Fenmore didn't get kickbacks—

The Witness: Hicks.

The Court: All right.

The Witness: Hicks denied getting any kickbacks on the commissions. Fenmore accused Rogen and Millman of being troublemakers, of trying to instigate us against him, and stirring up trouble needlessly. It was just an unpleasant and unhappy meeting. It was a falling out of—

The Court: Then what happened after that meeting? What happened after that meeting?

The Witness: There were subsequent meetings. Because of the fact that we had partnership assets nothing was being done with them, they were lying dormant.

The Court: Did you have a meeting in September?

The Witness: Well, your Honor, I—

The Court: You don't remember?

The Witness: I can't pinpoint it that closely. I know that during this four- or five-month period, from August to December,—

The Court: Yes.

The Witness: —August through November, that there were a number of meetings. I mean we felt there was a serious problem.

The Court: Did these same subjects come up and were [fol. 80] they discussed at each one of them?

The Witness: Yes, always the same subjects, they charged that Hicks—we talked to his sales manager, who was then no longer with Hicks, and he said he had to kick back commissions to him.

The Court: When was the first time that anybody talked about selling the property?

The Witness: Finally after a number of these meetings, none of which ever ended on a note that resolved anything, the feeling of bitterness was growing stronger among the

partners, and when Hicks came to us and said, "I will buy the Century property—"

The Court: When did Hicks say that, about?

The Witness: October or November of '54.

The Court: He bought it in October, didn't he?

The Witness: Well, that is what he said, that he would buy it, because he bought it fast.

The Court: He did?

The Witness: Yes, sir.

The Court: All right.

By Mr. Altman:

Q. Mr. Malat, were any representations as to a C-2 possibility made close to the time of the sale?

A. Yes, there were, because when we were having these arguments, I insisted that we explore the possibility of C-2 [fol. 81] zoning. Fenmore had kept telling us, "There is no chance," and finally at my urging he set up a meeting with Mr. Johansen at the City of Inglewood.

The Court: Johansen told you there was no chance?

The Witness: To forget it, there was no chance.

The Court: That was when, when Johansen told you that?

The Witness: That was right around July or August or September of that same year.

* * * * * * *

[fol. 82] The Court: How many times did he talk to Mr. Johansen with Mr. Hicks?

The Witness: I met with Mr. Johansen—

The Court: With Mr. Hicks.

The Witness: With Mr. Hicks? I never—

The Court: Mr. Fenmore.

The Witness: I met with Mr. Johansen twice, but only once with regard to the commercial zoning. Once was earlier, much earlier than April with regard—when we went into our application, our original application for rezoning.

The Court: Was Mr. Fenmore there?

The Witness: Yes.

The Court: And that was when?

[fol. 83] The Witness: That was—

The Court: That was the original rezoning.

The Witness: Yes. That was right after—

The Court: That was before the escrow closed?

The Witness: That is correct, your Honor.

The Court: The only other time you were there was when? Was it in April?

The Witness: It was May, June, July—it was during the time when the arguments among the partners started.

The Court: What was this April meeting you had with Fenmore and Johansen?

The Witness: It might not have been April. It might have been May or June. It was in this time we were arguing. And finally at my insistence we met with Mr. Johansen, and he said no.

[fol. A]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

Honorable E. Avery Crary, Judge Presiding.

No. 63-169-EC

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue, Defendant.

Reporter's Transcript of Proceedings—February 20, 1964

APPEARANCES: Same

[fol. 88] Los Angeles, California, Thursday, February 20, 1964. 10:00 A.M.

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[fol. 112] Mr. Altman: Before offering this, your Honor, counsel and I have stipulated that the basis of the property involved in these two sales is the cost in the escrow in which it was purchased in the first place, and that there were no improvements, no additions to that cost.

Am I correct?

Mr. Bay: That is correct, your Honor.

• • • • • • • •

[fol. 115] By Mr. Altman:

Q. Mr. Malat, the portion sold to Ponty and the portion sold to Hicks and Fenmore, do they have any improvements of any kind on them?

A. No.

• • • • • • • •

[fol. 120] Q. Do you recall, Mr. Malat, in regard to Plaintiffs' Exhibit 24 for identification whether you received a similar copy at the time indicated on the document?

A. Yes.

Q. Does the document refresh your recollection as to the events at that time?

A. It does.

Q. And the date, the date is what there?

A. July 23, 1954.

Q. Are you able to say, having refreshed your recollection, as to what events occurred at that time?

A. Yes.

Q. Will you state what they were?

A. Well, Mr. Fenmore had prior to July 23rd informed me—our offices were in the same building. We were on the [fol. 121] second floor and he was on the first floor and we saw and spoke to each other frequently. He had informed me that one of the large oil companies was interested in ac-

quiring the corner of Crenshaw and 104th Street for the purpose of erecting a service station. I says, "Fine." I said, "Advise the other partners and me, as well, with a memo so we can all consider it."

The Court: This was a part of your property, was it?

The Witness: Yes, sir.

The Court: All right.

The Witness: This was the southerly portion of the Crenshaw frontage. The Crenshaw frontage terminated at 104th Street.

The Court: This portion was ultimately sold to—

The Witness: Mr. Ponty.

The Court: Go ahead.

The Witness: I told him that, "Offhand, Max, my thinking is that we should not sell this corner for a service station because it could badly inhibit any future development of that entire property that it would lop off, the hunk it would lop off. If we keep the property as it now stands it has two street frontages, 104th Street and Crenshaw," which becomes very valuable in the development of commercial areas; two approaches.

[fol. 122] I said, "My thinking and recommendation is we should not consider any offer from an oil company to sell off a corner."

He said, "Well, I will advise the other partners what is happening and we will discuss it further."

Subsequent to this date there was a meeting of the partners and it was decided not to consider any offer from an oil company because it would, we thought, hurt our development plan.

By Mr. Altman:

Q. What development plan did you have in mind?

A. Well, we still had hopes in July we might be able to get the Crenshaw and Century frontages zoned for commercial purposes. If we were successful, then we could hurt any development plan by lopping off the gas station

site at that time. It is possible in a final development plan, if we got it zoned commercial, it would be desirable to have a service station, but we didn't want to make that move at that time, until we knew what our ultimate development plan would be, physical layout.

Q. Now, your ultimate development plan, was that for a sale of the properties?

A. No, it was for the development. One of the things we had in mind then was the desirability of a medical building, a building that housed medical offices, doctors and [fol. 123] dentists.

The Court: You were going to build that yourself, was that your plan?

The Witness: Yes, build these offices. As could be seen from the photographs just introduced, this area was very heavily populated, and at that point of time, in 1954, there were no such facilities close by at hand.

* * * * * * *

Q. Was there any plan for any other development?

A. Well, we first had to overcome the problem of zoning before we could get into a more definitive plan. One specific idea was the medical building, because we felt [fol. 124] that could be very lucrative and profitable, building that and renting it. We felt that there was a need for it in the area.

Anything else, retail stores, maybe a general office building. As I say, we had to take one thing at a time. And the first step to overcome was the zoning. If we couldn't get the zoning nothing we had in mind could work.

The Court: When you buy a piece of property and you hope to get it rezoned and you aren't able to get it rezoned, what was your plan here if you couldn't get it rezoned, Mr. Malat?

The Witness: We already had it zoned—

The Court: What were you going to do with the property if you couldn't get it rezoned?

The Witness: We already had it zoned R-3.

The Court: But you are talking about commercial zoning.

The Witness: Right. If we couldn't get it zoned commercial we hoped the market would improve and we would build apartments on it and keep the apartments and rent them. A more desirable and profitable zoning would be commercial.

The Court: Why didn't you keep them and build apartments?

The Witness: By this time, by August and September, [fol. 125] the rift had developed among the partners so that none of the partners wanted to stay partners with the other partners. They were looking for a divorce by now.

* * * * * * *

[fol. 128] Q. Mr. Malat, can you state what conversations [fol. 129] among the partners took place after July of 1954, between July and October of that year?

A. Yes, Mr. Altman, I can.

Q. Please do.

A. No less than two to three times a week Mr. Rogen and Mr. Millman were in our office—we were partners with Mr. Rogen in another deal, and we were very friendly with Mr. Millman. They came to our office and in every instance they were very articulate and vociferous in expressing their opinions of Mr. Fenmore, as our partner in the Century-Crenshaw deal, as an unmitigated louse and liar.

Mr. Bay: Your Honor,—

The Witness: This is what they told me. Then in conversation with Mr. Fenmore, Mr. Fenmore would tell me Mr. Millman and Mr. Rogen were obstructionists, they were children, that it was impossible to deal with them and the sooner he could terminate the partnership the happier he would be.

The Court: When did Fenmore make these statements to you?

The Witness: Often and regularly.

The Court: During what period of time.

The Witness: During the period of August, September and October of 1954.

The Court: Was there ever any statement between them [fol. 130] when everybody was there?

The Witness: Yes.

The Court: Fenmore was there and Rogen and Millman?

The Witness: Yes, there were two or three meetings during the months of August, September and October in the office of Mr. Fenmore when all five of the partners were there. The fifth partner, of course, was our partnership, and in almost every instance I represented the partners, Louis Lesser Enterprises.

The Court: What was said and by whom?

The Witness: At those meetings Mr. Millman and Mr. Rogen both leveled charges at Mr. Fenmore, that he was doing a bad job of managing the partnership. That he was deliberately blocking the zoning of the frontages commercial. They accused Mr. Hicks as having received kickbacks of commissions, which Mr. Hicks denied, and which we then found out that the charges were true.

That they would like to wind up the partnership, they didn't feel that there was any rapport.

The Court: When was the first statement by anybody about winding up the partnership?

The Witness: Around in October. Earlier than that there were just arguments between Millman and Rogen, on the one hand, and Hicks and Fenmore, on the other. I [fol. 131] was sort of in the middle, although I sort of sympathized with Millman and Rogen. I thought also that Fenmore and Hicks were double-dealing.

The Court: Do you know when in October?

The Witness: The date? No, your Honor.

The Court: Was it before or was it after you decided to make the sale to Hicks of this frontage on Century?

The Witness: No, it was before, because it was then that Hicks came to us and said, "If we are going to wind up the partnership I will buy the Century frontage from you."

* * * * * * *

The Court: The partnership was terminated, wasn't it, subsequently, Mr. Malat?

[fol. 132] The Witness: Yes, after the last two parcels were sold there were no further partnership assets other than some receivables. There were still some receivables in the partnership.

The Court: The partnership was terminated after the sale of the property?

The Witness: No, it was not until all the receivables had been collected.

The Court: Wasn't that after the sale of the property?

The Witness: Well, the receivables weren't collected until some time after the sales.

* * * * * * *

Q. Mr. Malat, will you state how the sale to Mr. Ponty developed, just what were the events that occurred that resulted in that sale?

A. Well, we got a call one day from Mr. Fenmore—this was November or December of '54, and I don't recall exactly—asking for a meeting of the partners.

I said, "For what purpose?"

He said, "Well, Carl has a proposition on the Crenshaw frontage he wants to discuss with the partnership."

The Court: Who is Carl?

[fol. 133] The Witness: Carl Hicks.

The Court: All right.

The Witness: I said, "Fine. I am available. Call the other partners and let me know when the meeting is going to be."

It was set for a day or two after my conversation with Mr. Fenmore, and we met. Mr. Hicks, Carl Hicks, then told the other partners he thought he could sell the Crenshaw frontage to Mr. Ponty.

Mr. Carl Hicks was a very close friend and had handled the sales of houses on tracts that Mr. Ponty had built. He wanted us to put a price on the property at which we

would sell it to Mr. Ponty, because Mr. Ponty—he said, "Mr. Ponty will not do any bargaining. Either he will accept your price or he won't."

Rogen and Millman called me out of that meeting and told me, "Bill, we want to sell it. We want out. We want to get through with Fenmore and Hicks and want to have nothing further to do with them on this deal. Let's give them a price and get rid of the property."

So I wasn't happy with the status of the relationship between the partners, because I was sort of caught in the middle.

I said, "All right. Go back and we will now discuss a price," which we did. We discussed a price and authorized [fol. 134] Mr. Hicks then to go back to Mr. Ponty and give him our price and either sell it or not at that price.

He came back shortly afterward—I don't mean that same day—a few days afterward and advised Mr. Fenmore, because Fenmore called me then and said, "Carl is down in the office here and he has got an O.K. from Ponty to go ahead with the purchase of the property."

We then proceeded to close the deal with Ponty.

* * * * * * *

[fol. 135] Q. Mr. Malat, speaking of developments in the area in which these properties lay, were there any other developments other than your subdivision around that immediate area about that time?

A. Yes, there were quite a few.

* * * * * * *

[fol. 136] Cross examination.

By Mr. Bay:

Q. Mr. Malat, would you describe what Exhibit A is, to the best of your ability?

A. United States Partnership Return of Income for the Fiscal Year Ending June 30, 1956.

Q. Sir, is that yours or a copy of the signature made by you on the original of such return on the bottom of page 1?

A. It is.

The Court: You said June 30, 1956?

The Witness: '56, yes, your Honor.

By Mr. Bay:

Q. Mr. Malat, would you turn to—

Mr. Bay: Your Honor, if your Honor will wait one moment I think we can avoid a lot of this. We are talking [fol. 137] about figures.

The Court: All right.

Mr. Bay: I think counsel will stipulate that the income which was reported on the return for the fiscal year ended June 30, 1956, of Louis Lesser Enterprises, Ltd. was reported in the individual return filed jointly by the plaintiffs in this case in their return, which is marked Exhibit B for identification.

Mr. Altman: You mean their share of it?

Mr. Bay: Their share of it, that is correct.

Mr. Altman: Yes, I will so stipulate.

The Court: The individual returns for the year '56?

Mr. Bay: Yes, your Honor, which is the year in question herein.

The Court: In their individual returns for the year '56.

Mr. Bay: That is correct, your Honor.

Mr. Altman: Wait a minute. Is this the year ended in 1956?

Mr. Bay: It is the year ended within 1956, which was reported on the plaintiffs' return for the calendar year 1956.

Mr. Altman: Yes, you are correct. I was thinking in the reverse.

Mr. Bay: I move at this time Defendants' Exhibits A [fol. 138] and B marked for identification be admitted in evidence.

Mr. Altman: No objection.

The Court: A and B are ordered in evidence.

(Documents marked Defendants' Exhibits A and B were received in evidence.)

By Mr. Bay:

Q. Mr. Malat, will you please refer again to Exhibit A in evidence?

The Court: B is a return, too, isn't it?

Mr. Bay: Yes, your Honor. B is the individual return.

The Court: Of the plaintiffs.

Mr. Bay: Of the plaintiffs, that is correct.

Q. Would you refer again, sir, to Exhibit A in evidence and specifically to page 1 of that return?

A. The face page?

Q. Yes, sir.

A. Yes.

Q. There is an amount reported as "Ordinary income (or loss)" in the amount of three hundred nineteen thousand dollars plus, is that correct, sir?

A. That is correct.

Q. Will you refer again to page 3 of that return? It is the third page of several pages attached.

A. Yes.

[fol. 139] Q. The figure at the bottom of that page is the same figure.

A. Yes.

Mr. Bay: For clarification, your Honor, that line reads "Ordinary Net Income For Income Tax Purposes". The top of that schedule refers to "Schedule of Income".

The Court: The ordinary income for tax purposes was three hundred nineteen thousand plus?

Mr. Bay: Correct, your Honor. This is by the partnership Lesser.

The Court: Yes. The Louis Lesser Enterprises.

Mr. Bay: Louis Lesser Enterprises, which we have referred to as Lesser.

The Court: All right.

By Mr. Bay:

Q. Mr. Malat, will you read down the list of the broad captioned items on that page, beginning with the first list?

A. Yes.

The Court: You mean which total this amount?

Mr. Bay: Yes.

The Court: All right.

The Witness: Read it out loud?

By Mr. Bay:

Q. Yes.

[fol. 140] A. "INCOME (OR LOSS) FROM PARTNERSHIPS", "INCOME (OR LOSS) FROM JOINT VENTURES", "INTEREST EARNED ON TRUST DEEDS", "DIVIDEND INCOME", "RENTS RECEIVED", "INCOME REAL ESTATE COMMISSIONS", "MISCELLANEOUS INCOME", "CAPITAL GAINS", "OTHER DEDUCTIONS", "ADJUSTMENTS FOR INCOME TAX".

Q. Now, the first several categories you mentioned, down through "CAPITAL GAINS", below there there is a caption of "Total Income".

A. Yes.

Q. And that figure is $701,372.55?

A. That is correct.

Q. Now, several of these previously mentioned categories comprise that amount, is that correct?

A. That is correct.

Q. Mr. Malat, the first captioned category here is, as you stated, "INCOME (OR LOSS) FROM PARTNERSHIPS".

There are several various categories of income or sources of income, various partnerships listed, is that correct?

A. That is correct.

Q. Sir, would you state what interest Louis Lesser Enterprises had in The Rolomar Co.—Los Angeles, California, which is the first of these listed categories?

A. A one-third interest.

Q. Sir, what was the business of Rolomar Co.?

[fol. 141] A. The subdivision and sale of lots in the Sherman Oaks area of San Fernando Valley.

Q. Were these improved lots?

A. Yes, sir. Not improved with structures, only improved with streets, off-site improved streets.

Q. Were they improved in a manner similar to the way in which the inner portion of Plaza was improved?

A. Yes.

The Court: In other words, you call that utilities, don't you?

The Witness: Yes. The off-site improvements, streets, curbing, gutter, paving and water utilities.

The Court: Yes.

By Mr. Bay:

Q. Do you recall what year Louis Lesser Enterprises became interested or a member of The Rolomar Co.?

A. I don't recall now.

Mr. Altman: If it would help counsel, your Honor, I would stipulate that Louis Lesser Enterprises, as a part of its business, was a member of several ventures in which property was held for sale to customers in the ordinary course of trade or business.

The Court: And The Rolomar Co. was one of them?

Mr. Altman: I assume so from the fact that this was reported as ordinary income.

[fol. 142] The Court: Is that what you want?

Mr. Bay: Yes, your Honor.

The Court: All right.

Mr. Bay: Would you also stipulate the business in which these various partnerships was engaged was similar to that of the business of Plaza?

Mr. Altman: No, I will not.

By Mr. Bay:

Q. Mr. Malat, what is the interest in which Louis Lesser was interested in San Fernando Woods; to what extent, do you recall?

A. No, it was around 25 per cent, but I am not sure.

Q. What was the business of San Fernando Woods?

A. The construction of single-family residences, the construction and sale of single-family residences in the San Fernando area.

Q. Did San Fernando Woods at any time during its entire existence, from its inception or the inception, from the time in which Lesser was interested, to the present, ever sell unimproved property or property improved only to the extent of off-site improvements?

A. No.

The Court: What company was that you said, Lesser?

Mr. Bay: San Fernando Woods.

The Court: San Fernando Woods. All right.

[fol. 143] By Mr. Bay:

Q. What, Mr. Malat, is San Manuel Distributors?

A. San Manuel Distributors was a beer distribution business, San Manuel, Arizona.

Q. To what extent was Lesser interested in that venture, do you know?

A. I think 15 per cent.

The Court: When you say "improved property" it will have to be clear to me what you mean. Improved property to me normally means a house is on it or buildings. Now, when you say "improved property", are you limiting it now to just the utilities and paving, curbs, and the water, and so forth?

Mr. Bay: Your Honor, let us have three categories. Unimproved, which is plain, raw land;—

The Court: Yes.

Mr. Bay: —improved to the extent of off-site improve-

ments, which is the grading, curbing, and water and sewage,—

The Court: Yes.

Mr. Bay: —and improved in the sense of improved with construction on it.

The Court: All right. So when you say "improved property", that means with construction on it. If you say "improved only as to off-site improvements", then I will know [fol. 144] what you mean. Be sure you distinguish, now, and when you say "unimproved", that means, of course, there are no improvements of any kind, off-site or otherwise.

Mr. Bay: In order to facilitate the court and the witness, this is the standard way in which this is referred to.

The Court: Just so we understand.

By Mr. Bay:

Q. Is that correct, that that is the standard way in which we refer to these various types of improvements or unimprovements?

A. Well, sometimes the middle category is called improved lots, which is lots with off-site improvements.

The Court: You asked him if San Fernando had ever sold any unimproved property. I assumed by that you meant property without any improvements.

Mr. Bay: That is correct, your Honor.

The Court: It has nothing to do with off-site improvements, but just plain real estate.

By Mr. Bay:

Q. Mr. Malat, did San Fernando Woods ever sell property to the extent of off-site improvements?

A. It did not.

Q. Did The Rolomar Co. ever sell property improved to the extent of off-site improvements?

[fol. 145] A. That is all that Rolomar sold; it sold only that.

Q. Did The Rolomar Co. at any time during its entire existence ever sell raw land?

A. It did not.

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Q. Mr. Malat, we were referring, when a recess was declared, as to the various partnerships, and the one I began to ask you about was Lesser, Himmelstein, Bochet—B-o-c-h-e-t. What is or what was the business of that partnership?

A. It owned an office building, a small office building in the City of Phoenix. It owned a square block of downtown property on which there were some buildings, on which we were collecting rents, as well as a parking lot. And it owned some raw land—

Mr. Altman: Pardon me: Would the witness state what [fol. 146] he means by "we"?

The Witness: The partnership. We were part of a partnership.

The Court: What interest did Lesser have in it?

The Witness: We had a 50 per cent interest.

The Court: You owned some raw land, did you say?

The Witness: Yes; still do.

By Mr. Bay:

Q. Is that partnership still in existence?

A. Yes.

Q. Has that partnership ever sold property?

A. Yes.

Q. Has it ever sold any portion of raw land?

A. Yes.

Q. What is the business or what was the business of Grand Canyon Development?

A. You mean Garden Canyon Development?

Q. Excuse me. Garden Canyon Development.

A. Garden Canyon Development built houses for sale near Fort Huachuca, Arizona; H-u-a-c-h-u-c-a.

The Court: That is a jawbreaker. I remember that post well.

The Witness: And then it sold off the balance of the land that was still unimproved to a building.

[fol. 147] By Mr. Bay:

Q. What interest did Lesser have in Garden Canyon Development?

A. We had half of a half; 25 per cent.

Q. What is or was Magnolia-Ball Associates?

A. Magnolia-Ball Associates built and sold single-family residences in Garden Grove, California.

Q. Did Magnolia-Ball Associates even own raw land other than the land on which these residences were built?

A. No.

Q. What is Bauer-Lesser?

A. Bauer-Lesser was in the business of building and selling single-family residences in Northern San Francisco —South, I am sorry; South San Francisco, California.

Q. Did Bauer-Lesser ever own unimproved property other than that on which construction was completed?

A. No.

Q. What is or was San Manuel Motors?

A. San Manuel Motors was a Ford agency in San Manuel, Arizona.

Q. The next category, Mr. Malat,—that completes the list of partnerships on which there was income or loss on the schedule.

Can you recall in 1954 or 1955 any other partnerships in which Louis Lesser Enterprises, Ltd. had an interest [fol. 148] or any enterprise in which it alone was interested?

A. '54? What years, Mr. Bay?

Q. '53, '54, '55.

A. '53, '54—well, yes, it owned stock interests in corporations. We thought of them almost as partnerships because we owned 50 per cent of the stock and Mr. Kahn in San Diego owned 50 per cent of the stock of a number of

corporations that built and rented apartments; owned shopping centers in the San Diego area.

Q. Mr. Malat, referring to those partnerships in the San Diego area, would you explain the procedure that was taken with respect to developing the land in that partnership? Was the land acquired in a commercial state, or what?

A. Well, the—which land are you talking about?

Q. In San Diego.

A. Shopping-center land, for instance?

Q. Yes, sir.

A. Shopping-center land was acquired in a raw state.

Q. In a raw state?

A. In a raw state.

Q. Is the zoning usual or does it vary, or what?

A. It was zoned commercial.

Q. I believe you stated on your direct examination there were two such shopping centers in the San Diego area.

A. That is correct.

[fol. 149] Q. Were they both zoned commercial when you acquired this property?

A. Yes. Then we built about 350 duplex units in San Diego, which we still own. We built those. We bought raw land, developed it, installed the street improvements and built the duplexes and rented them, and we still own them and still rent them.

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[fol. 150] Q. Did Garden Canyon Development at one portion sell some raw land?

A. After it built and sold some houses, yes.

Q. Do you recall to what extent that raw land—I withdraw that.

What was the footage or acreage of that raw land, do you recall?

A. No, I don't.

Q. Was it more than three acres?

A. Yes.

Q. Was it more than ten acres?

[fol. 151] A. Closer to 40 or 60 acres.

Q. Was it in one particular contiguous area?

A. Yes.

Q. Or was it all contiguous land?

A. It was all one single parcel of land.

Q. You stated that that was Garden Canyon Development?

A. That is correct.

Q. What interest did Lesser have in Garden Canyon Development?

A. 25 per cent.

Q. Thank you, sir.

Mr. Malat, on the return the next caption listed is "INCOME (OR LOSS) FROM JOINT VENTURES", and there are four categories in there. Two of them are labeled "Pendleton Joint Venture".

What is or was the Pendleton Joint Venture?

A. We had an interest in a construction contract, general contract, for the construction of a Wherry Housing Project at Camp Pendleton in San Diego County. This represented our participation in the general contract.

Q. What was the nature of the Wherry contract or the Wherry-type project?

A. Well, in this particular instance it was just a general contract to build the buildings for an owner.

We also had substantial interest in other Wherry proj-

[fol. 152] ects that were kept for rental, one of which we still own. But in the case of the Pendleton Joint Venture we only participated in the general contract for the construction for profit, if there was a profit. In this instance there wasn't.

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Q. What is or was the Heftler Construction Co. of East Orange, New Jersey?

A. Well, that was a sort of a two-way deal. We were partners with Heftler Construction in the construction con-

tract involved in building Wherry, certain Wherry Housing Projects.

Then we were also partners by a stock ownership in the ownership and operation of the Wherry Housing as rental projects. In those days you had to own a Wherry Project in an FHA-controlled corporation, so we couldn't own our interest through a partnership. It had to be through a stock interest in a separate corporation set up for each project.

[fol. 153] We had interests in quite a number of Wherry Housing Projects at that time that were all rental units at military bases.

Q. Further down the list there are other categories which have no relevance whatsoever to real estate, so far as is evident, or the sale of real estate.

But there is another category of "INCOME REAL ESTATE COMMISSIONS". What is that, sir?

A. Just before that there is an item of "RENTS RECEIVED", which relates to real estate.

Q. Excuse me. How much is rents received?

A. $16,938.27.

Q. What is the next category?

A. "INCOME REAL ESTATE COMMISSIONS".

Q. How much is noted by that caption, sir?

A. The gross amount of $140,733.78.

Q. What was the nature of these commissions?

A. The participation in the commissions paid for the sale of houses that were built and sold by Alden Construction Company on many of their subdivisions and a couple of other builders from whom we received sales—contracts to sell houses for them in subdivisions they were building.

The Court: You mean your company would contract to sell a block of houses and then when you sold them you got commissions on them?

[fol. 154] The Witness: Yes, your Honor.

The Court: I see.

By Mr. Bay:

Q. Mr. Malat, you were engaged during the years involved in the sale of houses, is that correct, to some extent?

A. You mean I personally?

Q. No, Louis Lesser Enterprises.

A. Yes, it had interests in partnerships that were building and selling houses.

Q. You did on occasion sell real estate to the extent of off-site improvements, is that correct?

The Court: You mean some of these partnerships they had interest in?

Mr. Bay: Yes.

The Witness: Some of our partnerships were engaged in the sale of improved lots or lots improved only with off-site improvements.

By Mr. Bay:

Q. You, in addition, on occasions sold raw land through some of these partnerships other than Century Crenshaw Plaza?

A. I think the only partnership that sold raw land is Garden Canyon. In winding up its affairs it sold off the balance of the land that it owned.

[fol. 155] Q. Mr. Malat, when did Louis Lesser Enterprises, or when did you as a partner of Louis Lesser Enterprises, enter into the real estate investments or real estate business, as such? What year, approximately, do you know?

A. You mean individually or through the partnership?

Q. Through the partnership.

A. The partnership was formed in 1952, I believe.

Q. Did you personally engage in real estate activity in any form prior to 1952?

A. Only as an investor. We were engaged in the manufacture of ladies' coats in that business. I was an investor in a few housing deals, subdivision housing deals, as an investor.

Q. Were you subdividing real property?

A. The entities that I invested in did.

Q. Were these partnerships—

A. There were—

Q. —or were there some partnerships included?

A. There were some corporations.

Q. Louis Lesser Enterprises is today a corporation, is that correct?

A. It is today a corporation, a publicly-owned corporation.

Q. Mr. Malat, do you recall approximately what month you were approached in 1953 by the—I believe you stated [fol. 156] earlier, by Millman and Hicks, is that correct, sir, with respect to the acquisition of the forty-five—

A. It was Rogen and Millman, I believe.

Q. Do you recall what month? The purchase, we agreed, was made in August, went in escrow in August.

A. It was at least six months, closer to seven months before the escrow finally closed on the sale. I think the escrow is about a six-month escrow and there was a period of three to four weeks of negotiations with Mr. Chambers before we opened up the escrow. So it could have been a good—the escrow, I believe, closed in January of '54. I don't remember the month. If I knew the date of the closing of the escrow and we acquired the land, it was seven months prior to that.

Q. How do you recall what month during 1954 the alleged rift began?

A. Because the rift started—the animosity, the animus began—the partnership began to fall apart about four months before we made the sales to Ponty and Hicks, and those sales took place, I think, in November and December.

The Court: It has been stipulated they took place in October and November.

The Witness: Or October or November.

The Court: You said the rift started in July, I believe, [fol. 157] before.

The Witness: That is right, about three or four months before that is when things started to fall apart insofar as the relationship of the partners was concerned.

By Mr. Bay:

Q. You do not recall specific dates of meetings in which the partners met?

A. Specific dates?

Q. Yes.

A. Oh, no.

Q. Do you recall a specific two-week period within months or any specific time at all?

A. Of meetings?

Q. Yes.

A. Oh, no.

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[fol. 159] Q. Mr. Malat, during your experience as a real estate—in the real estate business, have you had many experiences of going before zoning authorities?

A. Yes.

Q. How many would you say, approximately, sir? Just a rough estimate.

A. Are you talking about myself personally or the company?

Q. Yourself personally.

A. Personally I would guess about a half a dozen; the company, 20 or 30.

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Q. Approximately 25 or 30, 35 times before various zoning authorities?

[fol. 160] The Court: He is talking about his company.

Do you mean you were up there yourself five or six times?

The Witness: I personally, on behalf of the company, appeared five or six times, and the company has had 20 or 25.

By Mr. Bay:

Q. Have you personally appeared before the—let me retract that a moment.

When I refer to your going to these hearings, I mean not only in a representative capacity but also in terms of just watching as an observer. Have you also visited on several occasions as an observer?

A. Yes.

Q. Do you recall whether or not you have appeared before the Inglewood Planning Commission on occasions other than those with respect to Plaza?

A. No, I have not.

Q. Do you recall having gone before any Inglewood Planning Commission at any formal meeting in connection with Plaza?

A. Yes.

Q. When was that, sir?

A. That was in connection with the application for the rezoning of the property on its original purchase.

[fol. 161] Q. To R-3 and C-2 in the corner?

A. Yes, that is correct.

Q. Do you recall whether that took place shortly after the purchase or shortly after you entered escrow?

A. It was after we entered the escrow.

Q. Was it prior to closing?

A. I believe so, yes.

Q. Do you recall having appeared at any other formal hearing before the Inglewood Planning Commission?

A. No, I do not.

Q. You stated in your testimony, I believe, that you attended some informal hearings before the Inglewood Planning Commission, or representatives?

A. No, I did not state I attended informal hearings before the Planning Commission. I attended an informal hearing with one of the men connected with the Planning Commission.

Q. That was Mr. Johansen?

A. That is correct.

Q. Do you recall when that was?

A. I know I gave a couple of dates. Precisely when I don't know.

The Court: Was it after the sale of the Crenshaw and Century front property or was it before?

The Witness: No, it was before the Century property.

[fol. 162] By Mr. Bay:

Q. Was it around the time of the distribution to the partners by Plaza of the inner portion?

A. No, it was subsequent to that.

The Court: This is the time you went down to see if you could get this zoned commercially, isn't it?

The Witness: That is correct. I was there with Mr. Fenmore and we talked to Mr. Johansen about the possibilities of getting commercial zoning.

The Court: And he held up his hands and said there was no chance.

The Witness: There was no chance at all, "Don't submit an application because it will be rejected."

The Court: Yes.

By Mr. Bay:

Q. Mr. Malat, did Mr. Fenmore at the time that you were considering or you were—strike that.

Prior to the time at which the formal hearing was had before the Inglewood Planning Commission, did not Mr. Fenmore represent to you at some time prior to that that he had discussed zoning on an informal basis with the Planning Commission or with Mr. Johansen or some representative of the Inglewood Planning Commission?

A. You say prior to the formal hearing, are you talking [fol. 163] about the—

Q. The initial hearing.

A. —initial zoning hearing?

Q. Yes.

The Court: This is the R-3, now, you are talking about?

Mr. Bay: Going into R-3—

The Witness: Yes.

By Mr. Bay:

Q. And the C-2 on the corner.

A. Yes. Yes, he told me he had had an informal conference with the planning officials of the City of Inglewood.

Q. Did he also tell you that there was little likelihood of your obtaining C-2 on the frontage property and that you ought to take R-3, develop it and possibly come back at a later time, after it was developed, for C-2?

A. No, he could not have told us that at that time, because—

Q. Why do you say that, sir?

A. Because the condition of the purchase escrow for the land was that our zoning application would be for C-2 only on the corner that was being retained by the seller. And that our—the zoning for the balance of the property had to be requested R-3. Therefore, our initial intention [fol. 164] was to only request R-3, to conform with the conditions of the escrow. Our hopes were that at a subsequent date, after this was accomplished and we owned the property, we might then be able to rezone some of the frontage to commercial. But our initial discussions and our initial application was only for R-3 for our requisition for C-2 for the part retained by the seller.

Q. Did Mr. Fenmore, though, not indicate to you at or about that time, when you were discussing this, that he had informally discussed the potential of getting C-2 on the frontage property?

A. Not at that time, he did not, because we didn't even deem it wise to ask informally whether at a future date we could get it. We didn't want to cloud our initial application.

Q. Mr. Malat, what was the financial market in 1953, on or about August 12th, the date you went into escrow?

A. I will give you a one-word description, rough.

Q. Well, was it rough, sir, as to potential FHA 608 or 207 projects?

A. Yes.

Q. Did you not then consider the possibility that you may not be able to zone or might not be able to develop the entire parcel into FHA?

A. We arrived at that conclusion after we explored the [fol. 165] mortgage market, yes.

Q. Did you not then consider the possibility of developing the inner portion commercially and holding onto the balance and getting commercial zoning?

I am sorry. The inner portion—excuse me, sir—the R-3 residential in some fashion and doing something then with the other portion?

A. Yes, we explored the mortgage market and came to the conclusion that an FHA project was not feasible, that we could not get conventional financing on a large project. We decided to go ahead and subdivide the property. We continued to explore conventional financing on single four-, six-, and eight-unit buildings, and we were unable to accomplish that.

Q. I see. At the time you decided to subdivide then, the inner portion, did you not know then that it was unlikely that you would be able to obtain C-2 commercial zoning on the frontage property?

A. No.

Q. You never had any idea it would be difficult?

A. No.

Q. Didn't Mr. Fenmore represent to you that it would be difficult?

A. Oh, yes. We hadn't abandoned the hope of accomplishing it at the time we prepared the subdivision map.

[fol. 166] Q. What about at the time you began grading and improving the property, to the extent of off-site improvements?

A. In August I don't think we had yet abandoned all hope. We weren't tremendously optimistic. We hadn't done our exploratory talk with the City of Inglewood yet.

Q. Does it frequently, Mr. Malat,—well, let me back off a moment.

Do you frequently get into situations where zoning variances and zoning changes are necessary or feasible or desirable in your work?

A. Oh, yes.

Q. Does it normally take some period of time, even to convince the planning authorities informally that your change, your desired change, has merit?

A. Sometimes it does and sometimes it is accomplished at the first conference.

Q. I see. You sold the property, though, to Mr. Hicks on behalf of Hicks-Fenmore Development Company approximately two months after the subdivision off-site improvements were commenced, is that correct?

A. That is correct.

Q. And during the interim you fully explored the possibility of getting commercial zoning and were very satisfied in that short period that you would not be able to get C-2 zoning, is that correct?

[fol. 167] A. That is correct, because Mr. Johansen said, "There is no hope. Don't waste your time." That was about as final as we thought it could be.

Q. Was your purpose initially to develop the entire 45 acres into an FHA project?

A. When we initially bought the property?

Q. Yes.

A. Yes, this is what our initial purpose and intent was.

The Court: When you say an entire FHA project, do you mean family dwellings?

Mr. Bay: I mean FHA 608 or 207 projects.

The Court: What does that mean?

The Witness: May I explain?

The Court: Yes.

The Witness: This is an apartment project under the FHA project concept, which is more than a four-unit dwelling. Any more than a four-unit dwelling falls under an

FHA project title. The present one in connection with the 207 are the renewal 220. Those are the title numbers. Prior to that there was a title 608. This means more than four family units in one project, and there have FHA projects varying in size from 24 up to 1,000 or 2,000 units.

The Court: All right. When you bought the property originally, the 49 acres, you had in mind developing the [fol. 168] entire 49 acres under this FHA project which called for more than four units.

The Witness: Well, the entire project less any portion that we might have indicated to us could possibly be zoned commercially, because commercial has more value to us.

The Court: You answered his question and you said you intended to do it. I wanted to be sure about it.

The Witness: Yes.

The Court: So you didn't intend to develop all of it under this FHA over four units?

The Witness: As much as was feasible, and again—

The Court: Well, it would have all been feasible if you had wanted to, wouldn't it? If it were zoned for that you could have done that when you bought it, could you not?

The Witness: When we bought it and got it initially zoned R-3,—

The Court: Yes.

The Witness: —we could have developed it if everything fell into place financingwise and costwise, we could, yes.

The Court: I mean from a zoning standpoint you could have?

The Witness: Oh, yes.

[fol. 169] The Court: But you say at that time you didn't have in mind developing all of it under this more than four-unit—on this more than four-unit project?

The Witness: No, because—

The Court: You had in mind holding out the front part—

The Witness: Faint hopes of—

The Court: —hoping you might—your had in mind you might not get it and then if you didn't you were going to go under this more than four units?

The Witness: That is right.

The Court: That is what I understood. When you said you were going to do it all I wondered. I understand it now.

You weren't going to develop all of it under this when you bought it?

The Witness: Not at one time.

The Court: No,—

The Witness: When I say not at one time, we were going to reserve the portions we had hopes of getting commercially zoned.

The Court: All right. I understand.

By Mr. Bay:

Q. Do you recall when the idea of commercial zoning or commercial rezoning with respect to this 45 acres was first [fol. 170] explored?

A. When it was first explored?

Q. Yes, with Inglewood.

A. With the City of Inglewood?

Q. Yes. Either informally or formally, or in any fashion.

A. It was only done informally, as far as I knew.

The Court: It was after you opened escrow for the property?

The Witness: It was after we opened escrow, yes.

The Court: He already testified to that.

The Witness: After the map was recorded, as a matter of fact.

By Mr. Bay:

Q. Mr. Malat, I didn't quite get this, but I believe in the last day's session you referred to a conversation that you had, I believe, with a Milton Gordon, is that correct?

A. That is correct.

Q. Who is Milton Gordon?

A. Milton Gordon is a mortgage broker.

Q. Do you recall when this conversation took place?

A. This was almost immediately after we put the piece into escrow, put the land in escrow.

Q. Do you recall who else was at the meeting, other than Mr. Gordon and yourself?

[fol. 171] A. I don't know if any of the partners at that time knew Mr. Gordon. We had done business with him and knew him. He was a mortgage specialist in FHA financing.

Q. Is Mr. Gordon the individual who, in effect, soured, so to speak, on the hopes of FHA?

A. To a great extent, yes, because he had a very close touch with the mortgage market as it related to FHA projects.

Q. You stated, Mr. Malat, that the market was lousy or not very good during this period of late '53.

The Court: He said it was rough.

By Mr. Bay:

Q. Rough. Excuse me.

The Court: That is all right.

By Mr. Bay:

Q. The market, there is some correlation between a loose or a tight market with respect to FHA financing and conventional financing, is that not true?

A. When a mortgage market is rough it is rough in every aspect, whether it be FHA or the conventional market.

Q. Did you consider the mortgage market before you entered into the acquisition of the 45 acres as one of the factors?

A. We knew the market was rough then, because we were involved in other pieces of land that we were trying [fol. 172] to get financing for. But we had a six-month escrow and mortgage markets change sometimes quickly. It is not a gradual tightening or loosening of mortgage money many times.

Q. Mr. Malat, would it be possible to at any time prior to the closing of escrow for you to, in effect, get out from under the purchase? Would it be possible?

The Court: You mean by virtue of some condition in the escrow instructions?

Mr. Bay: No, your Honor. I am referring to—I don't believe there was any condition in the escrow—well, other than any specific condition.

Q. In other words, are you legally committed to complete the purchase?

A. Well,—

The Court: You mean were they when they entered into the escrow?

Mr. Bay: Yes.

The Court: For the 49 acres?

Mr. Bay: Yes, the 45 acres, your Honor.

The Court: It isn't 49 acres?

Mr. Bay: No, it is 44.901 acres.

The Court: All right. I stand corrected.

The Witness: You are now asking me for a legal opinion, and I quit law school after one semester to get married, so I don't know, honestly, to what extent, other than the [fol. 173] conditions that were imposed in the escrow as the conditions precedent to the closing of escrow, to what extent we were bound. We wanted to buy the property so we wanted the seller to be as bound as we were, if we could satisfy ourselves of the conditions.

Now, upon the satisfaction of those conditions, to what extent we were bound I honestly couldn't express a legal opinion.

By Mr. Bay:

Q. Mr. Malat, do you recall whether the mortgage market was good or loose, as opposed to tight, during the period when escrow closed, on or about February 15, 1954?

A. The mortgage market was tight.

Q. It was still tight?

A. That is correct.

Q. Mr. Malat, did you during the period when you were considering—and I speak of you, referring to you as a part of Plaza—when you were representing a partner of Plaza, being Lesser, did you during that period consider the development of the frontage property to which we have been referring? I am speaking now of the Crenshaw property as well as the—

The Court: At what time are you talking about?

Mr. Bay: At the time—well, prior to the sale of that property.

* * * * * * *

[fol. 174] By Mr. Bay:

Q. Did you consider how much money would be involved in the financing or in the developing of this property?

The Court: You mean in what manner?

By Mr. Bay:

Q. In the frontage property.

The Court: You mean on the FHA basis or—

Mr. Bay: No, your Honor, with respect to—after they had subdivided the inner portion, the 25 acres, and they still had 20 acres which was raw land.

The Court: Yes.

By Mr. Bay:

Q. Did you consider the amount of money which would be required in order to develop the frontage parcels?

A. This would have depended entirely on the form the development took. It is not at all unusual for a development to be of such a nature you can mortgage out 100 per [fol. 175] cent of your land and building costs, so that it would have taken no money.

Q. Was it your intention to develop both the Century portion and the Crenshaw portion as commercial, or just the Century portion as commercial?

A. No, we had hopes that both parcels could be zoned. They both fronted on major arteries and were susceptible to good commercial development, if the zoning were obtainable.

Q. Well, don't we get down to the basic point, that the only reason you were intending to or the only reason you sold the property was that you were having a rift among the partners because you were holding the property, waiting for the zoning situation—

The Court: That is what he said, I think. He said that was the reason that they sold it, isn't that right?

The Witness: That is the only reason. We could well—

The Court: That was the only reason, they had a dispute.

The Witness: We could well still be sitting with that property waiting to develop it if there had been a rapport among the partners. We weren't pressed for cash. The inner portion had generated profit for the partners that would have cleared the land and we could have sat with it.

[fol. 176] By Mr. Bay:

Q. Mr. Malat, do you have any memoranda or any other written evidence that you may have noted or notes during the period of July to October of 1954, with respect to any meetings had between the various partners of Plaza, at which this so-called rift was erupting?

A. As a matter of fact, Mr. Bay, I did look for a date book of that year and because of three moves of offices we threw a lot of stuff away that we didn't want to clutter up the new offices with, and I was unable to find my datebook. Other than that I would have no note of meetings that took place.

The Court: There were no letters exchanged which would indicate, or have anything to do with this rift, were there?

The Witness: I don't know. There were memoranda that we received on matters pertaining to the partnership from time to time from Mr. Fenmore. I haven't been able to find my files on them. I am having the same problem with another matter that goes back that far. As I say, in moving offices—

The Court: That happens, I know.

The Witness: Yes.

By Mr. Bay:

Q. Mr. Malat, the total purchase price, as stipulated, [fol. 177] paid by Mr. Ponty to Plaza was $222,800.00.

First of all, sir, how was that price determined? You stated, I believe, Mr. Hicks was authorized on behalf of the partnership to approach Mr. Ponty with an offer—with a figure. Do you recall whether there was any discussion back and forth as to that figure with Mr. Ponty or Mr. Hicks on behalf of Mr. Ponty?

A. Not with Mr. Ponty, with Mr. Hicks. Again I am going to have to try to apply the same thinking we apply to similar transactions, and that is, with an odd amount like that I have to assume that it was computed on so much per acre. I know there was an odd number of acres, it was, I think, nine point—a fraction of an acre, so it must have been computed against so much per acre against the total acres.

Q. Do you remember whether there was an offer and counteroffer and then there was finally—

The Court: He testified Mr. Hicks said he thought Mr. Ponty would buy it, he wouldn't quibble about it; he would accept or reject their offer. So they got together and discussed it, and they gave Mr. Hicks a figure, which he took to Ponty and he sold it.

Isn't that in substance what happened?

The Witness: Yes.

The Court: That is what he testified to. If you want to know what they said and how they arrived at this

[fol. 178] figure between the parties, when they gave the figure to Mr. Hicks, you can ask him, of course. But that is in substance what he testified.

By Mr. Bay:

Q. Mr. Malat, do you recall the terms of the sale to Ponty? Let me refresh your recollection.

Is it not correct that on or about November 5th or at the time of sale Mr. Ponty paid the partnership $5,000.00 down and gave the partnership a note secured by a trust deed in the amount of $217,800.00, which would be the balance of the purchase price?

A. It doesn't ring a bell with me, Mr. Bay. You may have information available at this point. I don't remember the terms or the purchase, even the purchase price, until you mentioned it.

Q. Aside from the amounts involved, Mr.. Malat, did you recall there was a down payment made by Mr. Ponty and a note secured by a trust deed for the balance?

A. Yes, I recall it was not originally paid all cash.

Q. Now, was there any agreement between the partnership Plaza and Mr. Ponty that Mr. Ponty would subdivide the parcel, the land acquired by him in the 48 lots, obtain construction loans subordinating his loan arising as a result of the purchase from—or subordinating a note secured by the trust deed which he gave to Plaza, and then make [fol. 179] various payments against which there would be the leases of the property, of the trust deed? Was this the financing situation?

A. This strikes a chord in my memory, Mr. Bay, yes. He did subdivide the property into 48 lots. I believe we did agree we would subordinate our deed of trust to construction loans that he would obtain for the purpose of building apartment buildings. I believe there were some payments made to us from some of the proceeds of the construction loans. I know there were payments made to us against which we released lots to him, and we also used

those payments, I believe, to secure releases of the land from the purchase money deed of trust that was still on that property.

Q. That purchase money deed of trust which you gave to Chambers?

A. To Chambers, yes, that is correct.

Q. Or the seller of the property.

A. Yes.

* * * * * * *

[fol. 182] MAXWELL J. FENMORE, called as a witness on behalf of the defendant, having been first duly sworn, was examined and testified as follows:

* * * * * * *

Direct examination.

By Mr. Bay:

Q. Mr. Fenmore, would you state your present address, please?

A. My home address is 1036 Loma Vista Drive, Beverly Hills. My office is 10889 Wilshire Boulevard, Westwood.

Q. What is your occupation, Mr. Fenmore?

A. I am an attorney licensed in the State of California, and I also am engaged principally now in the real estate development and building field.

Q. During the period 1953-1954 were you a member of the partnership known as Century-Crenshaw Plaza?

A. If you will tell me which partnership was which I will try to answer.

Q. The partnership which held or acquired 45 acres.

A. Yes.

[fol. 183] Q. Do you recall, without going into the specifics of dates, the sequence of the various transactions with respect to that parcel?

A. The only way I could really answer you, if you asked specific questions I will try to answer them.

Q. Do you recall that on or about August 12th of 1953 a six-month escrow for the acquisition of the 45 acres was entered into by Plaza?

A. As you recall in my deposition, I was out of the country at that time. The escrow was entered into while I was in Europe.

I was invited into the partnership either by telegram—by cable or telephone, and I acquiesced from Europe and I learned of the details when I returned in September sometime.

Q. Do you recall having had a principal role with respect to appearances before the Planning Commission of the City of Inglewood with respect to the property?

A. Yes, I do.

Q. Do you recall making a formal appearance on behalf of Plaza with a view toward obtaining R-3 zoning on the entire 45 acres and C-2 zoning on a corner lot on the southwest corner of Crenshaw and Century?

A. Yes.

Q. Do you recall prior to that formal appearance hav-
[fol. 184] ing had any formal conferences with the planning authorities of the City of Inglewood?

A. Yes.

Q. Do you recall whether at these prior conferences, these informal conferences, you had any discussion with the zoning authorities concerning the possibility of obtaining eventually subsequent to the initial zoning?

The Court: Wait a minute. "obtaining subsequent to the initial zoning". You mean C-2 subsequently?

Mr. Bay: Yes.

The Court: You mean obtaining commercial zoning on certain portions—

By Mr. Bay:

Q. To be zoned R-3? Or at that time to be zoned R-3?

A. No.

The Court: So I understand it, as I understand your testimony, Mr. Fenmore, it is that you didn't discuss at

these preliminary meetings with the Inglewood Planning Commission the possibility of obtaining commercial zoning on a portion of this acreage, which at that time you were seeking to have zoned R-3.

The Witness: That is correct. If I can answer it in a little different way, your Honor.

The Court: Yes.

The Witness: At the same time that this was going [fol. 185] on—

The Court: In other words, you were trying to get R-3—

The Witness: Right.

The Court: —and the corner C-2.

The Witness: Correct, for the Murphy-Reardon Oil people.

The Court: Yes.

The Witness: In another partnership with which the Lesser-Malat people were not connected at all, I was also working with the Inglewood Planning Department to get commercial zoning on another corner, at Crenshaw and Imperial, of which I was a partner.

The Court: It had nothing to do with this?

The Witness: Nothing to do with this. Therefore,—again speaking from my end of it—I was not going to muddy the waters or confuse the issues, and in my thinking, in my programming, it was just to get a 10-acre zoning for Murphy-Reardon on this particular property, and R-3 on the rest, and the commercial down a mile away from this corner.

The Court: All right.

By Mr. Bay:

Q. Mr. Fenmore, during the entire period prior to the sale of the Crenshaw frontage to Mr. Hicks and yourself—

A. The Crenshaw frontage was sold to Mr. Ponty.

[fol. 186] Q. Excuse me. I mean the Century frontage that was sold to Mr. Hicks and yourself,—

A. Yes.

Q. —do you recall having any informal or formal discussions of any sort with the planning authorities of the City of Inglewood with a view toward obtaining commercial rezoning or commercial variances on the R-3 property?

A. I don't recall such discussions or meetings prior to the acquisition of the Century Boulevard property.

The Court: Now, wait a minute. Prior to the acquisition of the Century property—

The Witness: By Hicks and myself.

The Court: I see. Your question was before it was sold to Hicks and Mr. Fenmore, as I understand your testimony, you don't recall any conferences you had relative to rezoning that property C-2?

The Witness: That is right.

The Court: All right. I am clear now.

By Mr. Bay:

Q. Do you recall your having attended a meeting with Mr. Johansen of the Inglewood Planning Commission during this period or at any time in or about this time?

A. You say "this period". I can only say this: I had many, many meetings with Mr. Johansen and Mr. Bob Coop, the City Manager, and others in the Planning Department. [fol. 187] So if you can again try to narrow it down, I will try to answer.

The Court: What about the one with Mr. Malat?

By Mr. Bay:

Q. Do you recall ever having attended a meeting with Mr. Malat?

A. I don't recall any such meeting with Mr. Malat.

Q. Mr. Fenmore, is this the first time I have asked you that question?

A. This—

Q. Right now.

A. Yes. You say is this the first time?

Q. Did I discuss your testimony with you at all prior to the hearing today or discuss this question, that I might ask you this question?

A. Yes, you did.

Q. Did I ask you about—as to whether or not Mr. Malat had ever attended a meeting with you?

A. Yes, you did.

Q. Do you recall having given this some thought prior to today?

A. Yes.

The Court: You don't recall that he did?

The Witness: I don't recall that he did.

By Mr. Bay:

Q. Do you recall any discussions with—

[fol. 188] A. You are speaking of the informal meetings, I assume?

Q. Yes. Or formal.

A. Again, as I told you yesterday when you asked me the question, there were formal meetings in the counsel chambers with dozens and tens and hundreds, probably, of people, so Mr. Malat well may have been at one or more of those meetings. I don't recall.

The Court: Was there any discussion with the Planning Commission of the rezoning of the Crenshaw property? I mean this front or the Century front property to C-2 before those two properties were sold.

The Witness: I don't recall any such specific discussions.

The Court: All right.

By Mr. Bay:

Q. Mr. Fenmore, do you recall at any time since you acquired the 45 acres, as a member of Plaza, having any sort of a rift or a dispute among the various members of Plaza?

The Witness: Will you read that question back, please?

Mr. Bay: At any time, say.

(The question was read.)

The Witness: Yes.

By Mr. Bay:

Q. Do you recall when, in terms of relating it to various [fol. 189] sales by Plaza, specifically the sales to Hicks and yourself and the other sales to Mr. Ponty? Do you recall whether this rift or break occurred prior to or subsequent to that time?

A. It is my recollection that it occurred subsequent to the sale to Ponty and to Hicks and myself.

Q. On what do you base that, sir?

A. I base it on recollection. I base it on the fact that we ended up in a very nasty personal argument, which had to occur after the sale because Mr. Lesser contacted me and at that time Mr. Hicks was in the hospital getting an ear operation, a mastoid operation, and my wife was in the hospital having been operated within a couple of weeks before that for a serious cancer operation, and his telling me that he wanted to get a piece of whatever profit Mr. Hicks and I would get out of the purchase that we had made from the partnership.

The Court: Is that what started the rift?

The Witness: Yes.

The Court: There was no rift or conflict between the partners before that?

The Witness: Nothing of any serious nature other than the usual, as I say, partnership disagreements in policy and thinking.

The Court: Well, it is your testimony that so far as [fol. 190] any—you say differences in policy and thinking. Of course, as to when the rift started, differences in policy and thinking could cause a rift, of course.

The Witness: Yes, of course. But I don't—I have been in partnerships for many years and every man has an opinion, but that doesn't cause what I would call a rift, a serious divisive dispute among partners.

The Court: You say there was no rift before the sale of these front pieces.

The Witness: Yes.

The Court: No rift which resulted, in substance, in the partners saying, "Well, let's sell this. If we can't get along let's sell it"? You say there was no such—

The Witness: I don't recall any such. My own understanding of why we sold it, why, in our case why we bought it, was there was a chance to make a very substantial profit on the sale or sales, and we proceeded to do it.

The Court: What prompted the sale? You said that Mr. Lesser said he wanted a portion of the profits—

The Witness: This was afterward.

The Court: —of the sale to Mr. Ponty.

The Witness: This was afterward.

The Court: After the sale?

The Witness: That is right.

The Court: As I understand it from your testimony, [fol. 191] so far as you are concerned this is what started the rift? This is what started the bitterness?

The Witness: This is what started the bitterness, yes.

The Court: But before that you had had arguments as to policy?

The Witness: Yes, policy.

The Court: All right. Go ahead.

By Mr. Bay:

Q. Did you have serious disagreements or arguments in the nature of—I use the term "serious" and, of course, that is irrelevant.

Had you had serious arguments with either Mr. Rogen or Mr. Millman?

A. No. Mr. Rogen and Mr. Millman were partners with me in this other property we are talking about and we remained partners up until Rogen's death in 1960 and our sale of the property in '62.

Q. You were partners in another project?

A. Yes.

Q. This was the property at Imperial and Crenshaw?
A. Imperial and Crenshaw, yes.

* * * * * * *

[fol. 192] Cross examination.

By Mr. Altman:

* * * * * * *

Q. Mr. Fenmore, do you recall giving a deposition on December 27, 1963?
A. Yes, the one Mr. Bay took.
Q. Yes.
A. Yes.
Q. Now, I would like to read from this and ask you whether it was your statement—whether it was true or false.

* * * * * * *

[fol. 193] "Q. What was the purpose in Hicks-Fenmore Development acquiring it? Was it because it was thought that Hicks-Fenmore Development was still interested in pursuing this line?"

C-2 and so forth, I think he referred to.

"Whereas the others were not and they sought to bail out themselves, or what?

"A. Well, I think it goes much further than that. We were not happy with the other people, especially Lesser, and we made the partnership an offer of a substantial price for the land and said either the land should be sold to somebody else or sold to us.

"I can only go back to say it was not a pleasant period in our relationship and that is the way it ended up."

Was that statement true or false, Mr. Fenmore?
A. I would assume it was true.
Q. Now, on page 25, down at line 19:
[fol. 194] "Q. What were your thoughts concerning the advisability of selling the parcel to Ponty at that time? Was it merely the idea of getting out because you were

unhappy with the other venturers, or was there a profit motive, or what, or was it a combination of factors?

"A. Well, I would say it would be a combination, but I can say our personal relationship was not a happy one."

Was that true or false?

A. I would say that is true.

Q. Mr. Fenmore, before you and Mr. Hicks bought that parcel on Century—was it Century?

A. Century.

Q. —did you say that you had talks with the Planning Commission about a rezoning to C-2?

A. It is my recollection that we did not discuss specifically the rezoning of that property to C-2 before we bought it.

Q. All right. Then I will read from your deposition on page 24, line 15:

"Q. Was there no desire on the part of the venturers—" and I believe the reference there was to Century-Crenshaw Plaza

[fol. 195] "—to develop this property or to enter into the leasing of it on a strip store basis?

"A. There was a desire. As I told you a few moments ago, I had these meetings with the City Planning and City Council people in Inglewood, and the end result was that they discouraged me completely from trying to seek C-2 zoning for the two strips because they said we couldn't get it—we wouldn't get it."

Pardon me.

Is that true or false?

A. If that was my testimony, then that was my testimony. I was going there as I am today; ten years of memory.

Q. And this was a reference to a period prior to your purchase, am I right?

A. That as far as the deposition is concerned, that is right.

. . . . . .

Q. Mr. Fenmore, I will show you Plaintiffs' Exhibit 14, a grant deed from Century-Crenshaw Plaza, a partnership, dated October 21, 1954, and showing that it was recorded on October 25, 1954, and ask you if that refreshes your [fol. 196] memory as to the time when you bought the property.

A. Yes.

Q. I mean at the time when Mr. Hicks bought the property.

A. Yes.

Q. And would the closing escrow statement, which is in evidence as Plaintiffs' Exhibit 13, refresh your memory as to the date when the escrow on that purchase was closed?

A. Well, actually it wouldn't, because it only shows the name of Century-Crenshaw Plaza here and there is no other name to go with this.

Q. Does the amount—

A. It doesn't ring a bell so I can't answer it.

Q. If this—

The Court: It was closed before the deed was recorded, wasn't it?

The Witness: Simultaneously.

The Court: Yes, that is what I mean.

The Witness: Yes.

By Mr. Altman:

Q. Simultaneously—

The Court: With the recording of the deed.

By Mr. Altman:

Q. So that the recording of the deed on October 25th, that would show that the escrow was closed on October 25th.

[fol. 197] A. That is generally the case.

Q. Now, I will show you, Mr. Fenmore, a letter from you to Mr. Johansen, dated October 21, 1954, and in evidence as—no, not in evidence, but as Plaintiffs' Exhibit 16 for identification, and ask you whether you wrote that letter.

A. I would assume I did.

Q. And this application for rezoning dated October 21, 1954, which is Plaintiffs' Exhibit 21 for identification, I will ask you if this was filed by you.

A. If this is the application that went along with this letter, then I would assume I did. My name doesn't appear on here. That is why I am saying that.

Q. Were you representing Mr. Hicks in the application at that time?

A. That is why I am saying that if that is the application that went along with this letter, then my answer is yes.

The Court: Can you tell by looking at the application whether it is?

The Witness: No, I can't. That is exactly the point, I can't. Yet the date—

The Court: For commercial zoning—

The Witness: Application for commercial zoning, that is right, and it is Exhibit 21 for identification and it bears the same date. That is why I say—other than that, my name doesn't appear. I have no independent recollection [fol. 198] of it.

By Mr. Altman:

Q. I will show you, Mr. Fenmore, a certified copy of a grant deed dated October 29, 1954, from yourself—no, no, from Mr. Hicks to yourself—

A. Right.

Q. —of a half-interest in the same property. Would that refresh your recollection as to the title owner of the property on October 25th? I mean, was it purchased first by Mr. Hicks and then a half-interest sold to you?

A. Yes.

Q. So that, Mr. Fenmore, when you filed the application it had to be filed in the name of Mr. Hicks, is that correct?

A. All I can say is the application was filed in the name of Mr. Hicks.

Q. Thank you.

Now, this application was actually filed then several days before Mr. Hicks actually owned the property, am I correct?

A. From the documents you have shown me here, I would have to answer yes.

* * * * * * *

[fol. 200] Mr. Altman: Beginning at line 12 of your deposition:

"Q. In April 1954 there was an informed transfer of the title of the property from the various entities and individuals as joint venturers to the individuals and then subsequently a transfer to Properties. Subsequently, approximately six months later, one of the parcels, I believe the parcel on Century, was sold to Hicks-Fenmore Development Company."

That should have been Crenshaw, shouldn't it?

[fol. 201] Oh, Century. Pardon me.

The Witness: Century.

By Mr. Altman:

Q. "Was there any thought then of developing the property yourselves as commercial?"

The Court: This is April '54 you are talking about?

Mr. Altman: No, six months later.

The Court: Well, six months later. First they transferred it to the—from the joint venturers to the individuals and then to Properties. You say it was six months later it went to Properties.

Mr. Altman: This is all in the question, your Honor.

The Court: Yes.

Mr. Altman: First the statement that:

"In April 1954 there was an informed transfer of the title of the property from the various entities and individuals as joint venturers to the individuals and then subsequently a transfer to Properties."

The Court: Yes. When was the transfer to Properties?
Mr. Altman: May of 1954.

Q. "Subsequently, approximately six months later, one of the parcels, I believe the parcel on Century, was sold [fol. 202] to Hicks-Fenmore Development Company.

"Was there any thought then of developing the property yourselves as commercial? What did you have in mind doing with that property immediately after or around the distribution?"

I think that refers to transfer to Properties, when he speaks of "distribution", your Honor. It is a little difficult to understand.

The Court: I can well appreciate it. Go ahead. What is your question?

By Mr. Altman:

Q. "A. I don't know what the word 'informed' means in that question.

"Q. Let's forget it and treat the whole thing as one.

"A. I had been working quite intimately and on good terms with the planning staff and the City Manager, the Mayor and the City Council of Inglewood, so we thought it would be possible to utilize either the Century or Crenshaw frontage, those strips, one or the other, as a store, strip stores, as differentiated from a shopping center development.

"I had several meetings. Bob Coop, by the way, was then the City Manager, and I forget the name of the City Planner."

[fol. 203] Was that Mr. Johansen, Mr. Fenmore, the City Planner?

A. Yes.

Mr. Altman: I continue to read:

"But we had, oh, several meetings and discussed it, and they said inasmuch as the other group in which I was a partner had gotten the zoning and were

developing the shopping center at Crenshaw and Imperial, and because of the fact that the Murphy-Reardon piece was still zoned commercial at the corner of Century and Crenshaw, and that the City thought that there was more than enough commercial zoning in that area, and then another problem had developed about that time and there was and still is today a tremendous traffic problem on Century Boulevard because of the race track and because of the airport, so that I remembered Coop and this other City Planner, a great big guy about six-four, said it would not make sense even to apply because they would have to recommend against it and the Planning Commission would go against it.

"I had had a meeting with the Planning Commission informally, also. They would have to recommend against it and it would be a waste of time."

Mr. Fenmore, in the first place, this is a true state-
[fol. 204] ment?

A. I assume it was.

Q. Mr. Fenmore, this refers to the time when there was a transfer to Properties, doesn't it? When it says back here, "Was there any thought then of developing the property yourselves as commercial? What did you have in mind with that property immediately after around the distribution", that was the distribution to the individuals, which was followed by the transfer to Properties, is that right?

A. The word "distribution" I would have to assume meant that. Now, whether the rest of the question carries that I don't know, Mr. Altman. The word "distribution"—

Q. Would indicate that you were thinking in terms of the time when Properties took over the property, the partnership property, when there was a distribution of the land to the individuals and a transfer by them to Properties?

A. Well now, if you will state your question as to that, I will try to answer it.

Q. Well, these meetings you had with the Planning Commission you did have about that time, didn't you, that you are referring to in this statement? About the time in May or so of 1954.

A. I don't think—I don't recall that discussions of anything having to do with a commercial nature were had at that time or about that time. Again I have to go by [fol. 205] memory and recollection because, as I said earlier, and I said in about four depositions, now, I was meeting with the Commission and the planners constantly during a period of about a year on this and various other things I was going to be handling.

Q. This may have continued up to a later time, is that correct? I mean your meetings and your discussions with the Planning Commission.

A. Again I am not trying to hedge my answer, but I am trying to give you a picture, trying to get a mental answer today, because Mr. Hicks and I also acquired other property later or about this time on Century Boulevard, on the north side of Century Boulevard, from other people, Gerson and Beck. We also went in on zoning on that piece.

So as to which and when the discussions were that took place, I can't pinpoint them. I can only go again by trying to do the best I can by memory.

Q. Yes.

A. My memory, to the best of my ability, is that we did not discuss commercial on this property at the earlier date you are talking about.

Q. Mr. Fenmore, referring again to your letter of October 21st, where you say in the second paragraph:

> "I would appreciate it greatly if you would have the application placed on the agenda for Friday, No- [fol. 206] vember 5th, and have Mr. Benton James start the necessary property owners' list, drawings, and so forth, that would be required. I will furnish you with additional photographs and other data prior to the hearing."

Did you have any view at that time as to whether you could or could not get the commercial zoning?

A. My view still was that we could not get the commercial zoning.

Q. But still you went ahead—

The Court: As of what time, now? As of—

Mr. Altman: October 21, 1954.

The Court: October 21st?

Mr. Altman: Yes.

The Court: October 21st, is that right, Mr. Fenmore?

The Witness: Yes, sir.

By Mr. Altman:

Q. Let me, for that purpose, refresh your memory, Mr. Fenmore, that that was the date of the—also the date of the deed on the property from Plaza to Hicks. In other words, are you saying within a couple of weeks, even though after months and months of discussions you had been turned down flat on rezoning, that you were able to get the rezoning then—a recommendation of a rezoning then within a couple of weeks from the Planning Commission?

[fol. 207] A. On the contrary, there was never a recommendation for a rezoning and there never was a rezoning.

The Court: You mean to C-2?

The Witness: That is right. There was a gas—we got a variance for a gas station site and then we got a variance for a motel-restaurant. There was a strict variance that we had to build it under certain plans and specifications. We never could get financing for it and it was never built. The gas station we did build. The motel and restaurant we never did, and there never was commercial zoning granted on the property.

* * * * * * *

[fol. 220] Mr. Altman: On page 18, line 8:

* * * * * * *

Let me go back a little ways. Beginning at line 3:

"Q. Was this true, now, with respect to both the Century and Crenshaw?

"Q. Or just the Crenshaw?

"A. That is right.

"Q. Or just the Crenshaw?

"A. No, it is my recollection that it was true as to both.

[fol. 221] "Q. The venture must have had some thought during this period, though, with regard to its purpose in either holding it or was it actually holding the property out for sale?

"A. No, it was not holding the property out for sale. You are speaking now of the frontages?

"Q. Speaking now only of the two frontage properties.

"A. No, I would say that I had just told you—what I have just told you was taking place at about that time and what I have condensed into a couple of minutes may have taken a couple of months of discussions. The property, and the property was never put out for sale, that is, neither frontage. The Crenshaw property was eventually sold to George Ponty and he made the offer for the property through Carl Hicks.

"Q. Did Hicks know him?

"A. Yes.

"Q. You did not know him?

"A. Not at that time. Hicks had worked for his father for some time.

"Q. For Spiros Ponty?

"A. Spiros Ponty, correct. Then Hicks and I bought the Century property, so there was never an offering [fol. 222] of brokers or anything."

Q. Is that—

A. Correct.

Q. Is that correct?

A. Correct.

* * * * * * *

[fol. 224] Redirect examination.

By Mr. Bay:

Q. Mr. Fenmore, did you at any time convey your thoughts to Mr. Malat, as well as the other partners or any of the partners of Plaza, that it would be very unlikely, based upon your discussions with the Inglewood people, that you would be able to get C-2 rezoning on the frontage property?

A. Yes.

Q. You did convey these ideas, these thoughts, to Mr. Malat?

A. To all of them.

Q. To all of them.

The Court: When was it?

By Mr. Bay:

Q. At what time, do you recall, Mr. Fenmore?

A. Well, again it is a mental and physical impossibility to specify time—

The Court: Yes.

The Witness: —because again, as I said in the deposition,—

The Court: Can you approximate it?

The Witness: I really can't, your Honor, specifically. It is almost impossible.

The Court: All right. Go ahead.

[fol. 225] The Witness: We were meeting all the time.

The Court: All right.

By Mr. Bay:

Q. Mr. Fenmore, was your zoning application to the City of Inglewood on behalf of yourself and Mr. Hicks granted?

A. No.

Q. Did you ever obtain rezoning of any property on Crenshaw within this tract?

A. On Century.

Q. On Century.

A. No. We got the variance that is now in the record.

* * * * * * *

Q. Mr. Fenmore, how long have you been in the real estate business?

A. In one percentage or another of my time I would say for twenty-odd years.

[fol. 226] Q. Do you make decisions in your business or have you made over the years decisions in your business with respect to valuation of property?

A. Yes.

Q. May I pose a hypothetical situation: Where property such as the property within the inner portion is developed to the extent of off-site improvements, it is subdivided, 105 lots subdivided, does that enhance the value of the frontage property, such as we have in this situation?

A. Normally I would say yes.

Q. What in general terms, Mr. Fenmore, were the factors upon which—or based upon which Plaza made the sale to Hicks-Fenmore?

A. I don't understand the question, I am sorry.

Q. What factors, what combination of factors or what single factor was the basis of the sale to Hicks-Fenmore Development?

The Court: What he is asking is, why did they sell it to you?

The Witness: I know we had a series of meetings, discussions, to try to figure out exactly why. There was a profit involved. There were—

The Court: Do you remember how it happened?

The Witness: Specifically? No, I don't—

The Court: What led up to the thing?

[fol. 227] The Witness: I don't remember specifically, no, your Honor.

The Court: All right.

By Mr. Bay:

Q. Do you recall that there was a substantial profit realized from the transaction?

A. Yes.

Q. Do you recall that this was a significant factor which led you to accept the offers?

A. I would say it would be one of the factors.

Q. Would the same—

The Court: Wait a minute, now. "led you to accept the offers"? What are you talking about? He bought it. He and Mr. Hicks bought this nine acres, this frontage on Century. Is that what you are talking about?

Mr. Bay: I will relate that question instead to the property sold to Mr. Ponty.

The Court: That is different. All right.

The Witness: Well, yes, I would assume that receiving a profit is one of the factors.

The Court: This is the sale to Ponty?

The Witness: Yes, yes, your Honor.

Mr. Altman: Your Honor, I will move to strike. He is only saying what he would assume.

The Court: Yes, the assumption, that would eliminate [fol. 228] it. If he doesn't know what the situation was, why, the motion to strike is granted.

By Mr. Bay:

Q. Do you recall what factors led you to make the sale to Mr. Ponty?

A. It would be really in line with what the judge just said. It would be impossible to cite what the specific factors were at this time.

The Court: You mean it is too long ago?

The Witness: Yes. Yes, your Honor.

Mr. Bay: Would the clerk please place Exhibit 24 in evidence before the witness?

(Exhibit was placed before the witness.)

By Mr. Bay:

Q. Would you read that to yourself, Mr. Fenmore?

A. Yes.

Q. Do you recall having sent this to various members of the partnership?

A. I don't recall, but seeing it this way I would assume again it was so sent or delivered, as the case may be.

Q. There is a reference in there to the fact that a major gasoline company had indicated some interest in a portion of the property along Crenshaw, is that correct?

A. Yes.

[fol. 229] Q. This was the portion of the property ultimately sold to Mr. Ponty, is that correct?

A. That is correct.

Q. With respect to that offer or interest, was there ever an actual offer made on the part of the gasoline company?

A. I don't recall any.

Q. Would this be what is known as a feeler?

A. Yes, yes.

Q. Were there ever feelers made by anybody, to your knowledge, with respect to any portion of the property along Crenshaw or the property along Century, similar to the feeler here?

A. Yes. Again, brokers—again, this is normal. Brokers will call up or write or come in and say, "Do you have—is this piece of property for sale or is that piece of property for sale?"

* * * * * * *

[fol. 230] Recross examination.

By Mr. Altman:

* * * * * * *

Q. Now, speaking of an increase in value resulting from the subdivision in the territory, that could happen from any subdivision in that area, couldn't it?

A. Yes.

Q. Not necessarily from this particular subdivision under the name of Properties?

A. Not necessarily.

Q. And it could also depress the value depending upon the character of the subdivision, am I right?

[fol. 231] A. You are right, and that is why I used the word "normally". Depending on what is done with surrounding or adjacent property to a considerable extent would determine the present or future value of any particular parcel.

Q. It could enhance or depress the value?

A. Yes. I say, depending on what you do with the rest of it.

* * * * * * *

Redirect examination.

By Mr. Bay:

Q. With respect to the particular property which was held by Plaza, the 45 acres, the entire parcel, do you recall any development within the area, the general geographical area between the period beginning in August 1953, when Plaza negotiated for the acquisition of the parcel, and 15 months later, in November of 1954, when the last parcel was sold to Mr. Ponty?

* * * * * * *

[fol. 232] Q. Do you know if there was any development?

A. In the 15 months from what date?

Q. The date that marked the beginning of escrow.

A. Which was what date?

Q. August 1953.

A. Yes, there were houses starting to be built south of 104th Street and east of Crenshaw Boulevard. Another shopping center at the corner of Crenshaw and Imperial was started in '54 sometime and opened for business in '55.

My recollection is there were also some houses built south of 104th Street on Crenshaw, because the school was

also south of 104th, just inside of Crenshaw, just west of Crenshaw. There were no other developments that I recall started in that period of time.

* * * * * * *

[fol. 234] WILLIAM MALAT, a plaintiff herein, called as a witness on behalf of the plaintiffs, having been previously duly sworn, resumed the stand and testified further as follows:

* * * * * * *

[fol. 235] Mr. Bay: On page 12 of Mr. Malat's deposition taken on Tuesday, November 19, 1963,—I will go back, your Honor, to page 11, line 24.

The Court: All right.

Mr. Bay (Reading):

"By Mr. Bay:

"Q. Mr. Malat, at the time that you were considering the zoning potential and the development potential of this property, did you contemplate, in acquiring the property, the possibility that rezoning or refinancing, or whatever, might not be possible?

"A. This is always a possibility in real estate development.

"Q. And what was your intention if that couldn't—I mean, you must have considered this as well.

"A. Well, this was a bridge that we all felt we would cross when we came to it. We would first do the things —we felt that we had made a good buy on the property as far as price is concerned, so that if we couldn't do anything in the way of zoning, we would sell the whole thing off in bulk. We wouldn't get hurt. So, there was no urgency. There was no need to say, 'Well, if this doesn't happen, and that doesn't happen—' we took one [fol. 236] step at a time.

"Q. You say you could sell off a portion or all of it in large bulk. Would you first secure the R-3 zoning?

"A. Yes."

On page 24, your Honor, of the same deposition—just a moment.

The Court: All right.

Mr. Bay: Your Honor, I will strike that reference to page 24.

On page 20, at line 13, again I was questioning the witness:

"Q. If there was no sight or no thought of zoning change, why did you sell these two frontage properties in large sectors or in one 'fell swoop', rather than in smaller portions? Why did you not break them up into smaller parcels?

"A. Well, did I understand your question correctly that you preface it with 'if there was no thought of rezoning'? Is that what you said?

"Q. Well, I believe by that time, you were able to see that there was no zoning about to be changed. You would learn informally that you would not be able to change it to C-2.

"A. Well, in other words—

[fol. 237] "Q. No good financing, as well, could be obtained. Let me rephrase the question.

"Wouldn't it, as a sound real estate sale,—well, in terms of contemplating the best possible price on a sale of property when one is intending to sell property, you would seek the best possible price? Wouldn't it be better to sell it in larger parcels than in smaller parcels? And I am thinking, now, with reference to these particular parcels involved.

"A. Well, there were a lot of elements that entered into the decision to sell finally after we realized that we had no hope of getting commercial zoning. There are a number of elements that contributed to our decision to sell the Crenshaw frontage to Ponty and ulti-

mately the Century frontage to Hicks and Fenmore. We originally sold it to Hicks. He brought Fenmore into the picture.

"Q. I see.

"A. Number 1 was: There was by this time a lack of rapport amongst the partners. Number 2, we had, we felt, done as much exploration of financing and rezoning as it was proper. When I say 'proper', we had money invested in this property that wasn't earning anything. And the partners had determined that [fol. 238] we would not be able to get commercial zoning for the frontage properties. The partners had also determined that the type of mortgage financing that we would like for apartment developing was not available. That is, financing that would permit us to build apartments for rent and get what we felt was a reasonable return on our equity investment. In light of those determinations, the partners then had a choice and decided that we had a situation that represented in our eyes and our thinking, a capital gain if we sold the property off in bulk as compared to subdividing it into lots. Incidentally, even at that time, we were not offering those properties for sale; the Crenshaw or the Century properties. They were not listed with brokers. They were not advertised for sale. They were not being offered for sale. An opportunity presented itself to sell it in bulk and after much soul-searching from the partners and the zoning, the financing possibilities, we decided to accept the offer that came to us. It wasn't an offer that was solicited or sought by the partnership. It's an offer that came to us and it was presented and we accepted it. This was the Ponty sale. And shortly thereafter, the same type of offer came [fol. 239] to us from one of the partners, and I might say that by this time, there was an air of acrimony amongst the partners and we felt this was one way of winding up a relationship that we were no longer happy with.

"Q. You refer to the possibility of getting capital gain. Was this on the basis of advice from certified public accountants or tax attorneys, or someone competent in the taxes, or what?

"A. Well, one of the partners was an attorney and although he wasn't an accountant, not a tax attorney, he expressed an opinion we felt, even as laymen, that we weren't experts, but we felt the sale in bulk—we had not planned that it was a capital gain."

* * * * * * *

Redirect examination.

By Mr. Altman:

Q. Mr. Malat, referring to this capital gain idea, where [fol. 240] did that come from?

A. Mr. Fenmore.

Q. Was that in connection with his offer or Hicks' offer to purchase the property?

A. Well, it was one of the things that he suggested to us as additional inducement for making the sale to Hicks, and then subsequent to Ponty. Since there was this bitter feeling, and we were going to get out, he says, "Well, we can wind it up. At least we can get rid of one piece now and take a capital gain on it."

Q. Mr. Malat, at the time you went into—I mean after you went into escrow on the purchase of the property from the original owners in 1953, did the mortgage market become better or worse?

The Court: He has covered that. He said it was rough as a cob, as I understand it. It was real bad when they bought the property—I mean when the escrow was opened and it was real bad six months later when they got the title.

The Witness: It was worse.

The Court: Rougher.

By Mr. Altman:

Q. You say it was worse?

A. It had worsened.

Q. At the time you made the purchase, what was your view as to what you could do with the property under [fol. 241] those financing conditions?

A. Well,—

Mr. Bay: Objection, your Honor. This has been covered.

The Court: Well, I don't know as it has. He said that they were—if they couldn't get the rezoning they planned to go ahead with the more than four units on the front property, as I understand it.

The Witness: That is correct.

The Court: And you said that the mortgage business was real tough then. But that is what he said they planned to do.

Mr. Altman: Yes.

Q. Did you feel you would be at that time, despite the character of the mortgage market, able to get financing within a reasonable time for that project?

A. When you say—

Mr. Bay: Objection, your Honor. That has been covered.

The Court: It has been covered, Mr. Altman. I think he said they might have to hold it, but they would hold it.

Wasn't that what you said?

The Witness: That is right.

[fol. 242] By Mr. Altman:

Q. Mr. Malat,—

The Court: He says, Mr. Altman, and it is very clear, he said more than once the reason they sold it was because of the acrimony and the dispute and the ill feeling between the partners.

Mr. Altman: Yes.

The Court: That is the reason they sold it. They had this plan and they would have held it and made R-3 if they couldn't get the commercial zoning.

By Mr. Altman:

Q. Mr. Malat, has Louis Lesser Enterprises, either directly or as a member of other partnerships, held raw land for any substantial period in order to hold until you could develop?

Mr. Bay: Objection, your Honor. We have already covered the activities of Louis Lesser.

The Court: Objection overruled. Go ahead.

The Witness: Oh, yes, I have property I own now we owned before we bought the Century-Crenshaw Property. When the right tenant comes along, if the right financing is available, we will develop it. Property in Pico Rivera that we have held for a long time. In fact, real property. We have developed some of it, and the rest of it we will hold until the right tenant comes along.

* * * * * * *

[fol. 243] Q. Mr. Malat, in reference to a sale of land, a hundred acres in Buena Park, are you familiar with the reason why that was sold?

A. I am.

Q. Will you state the reason?

Mr. Bay: Objection, your Honor. The witness has not stated how he is familiar with the reason.

The Court: Well, he is a partner. I don't know what this 100 acres is. He talked about selling some 60 acres.

Is that the one you are talking about?

Mr. Altman: No. This is 100 acres which is listed in the Louis Lesser Enterprises return, which is in evidence as Exhibit—

The Court: Which partnership had it?

Mr. Altman: —Exhibit A.

The Court: Which partnership had it?

Mr. Altman: Louis Lesser Enterprises.

[fol. 244] The Court: All right. I don't remember that. Did you sell a hundred acres?

The Witness: We did at Buena Park.

The Court: All right. And you were a partner in the organization that held it?

The Witness: Yes, sir.

The Court: Why did you sell? Is that your question?

Mr. Altman: Yes.

The Court: All right.

The Witness: Two reasons. It was sold at a time—we held it during a time when sales, housing sales had fallen off very substantially in Orange County, and the finance market seemed to go hand in hand. When housing sales fall the finance market is rough. When houses sell readily the finance market is easy.

That is what happened then, and finally we decided we just didn't want to wait for the market to get better and a buyer came along and we sold it.

The Court: How did you return it, as ordinary income or long-term capital gain?

Mr. Altman: As long-term capital gain.

The Court: Is that the way you returned it?

The Witness: Yes, sir.

The Court: All right.

[fol. 245] That isn't, of course, proof it was property returned.

What year are you talking about?

The Witness: '56. The year ending June 30, '56.

The Court: All right.

By Mr. Altman:

Q. How about the Torrance land referred to in the same return, can you state why that was sold?

A. Well, that was sold to a partnership in which we had an interest on a short-term basis. It was a short-term holding and then the partnership developed the property.

Q. So actually you continued to have an interest in the property.

A. That is right.

Q. Now, reference was made to a certain sale of land by Garden—

A. Canyon Development. Garden Canyon Development.

• • • • • • •

Q. Well, let me ask you the question again. What was the reason for the sale in that case?

A. We had developed a portion of a total parcel of land with houses and sold them. Sales had slowed down to [fol. 246] a slow walk and we considered it as a sort of a Mickey Mouse operation with no future. The builder who was building the houses was willing to buy the land, so we sold it. We didn't want to continue to develop it.

The Court: How was that returned?

Mr. Altman: It doesn't appear in here. Apparently at the time, during this year, your Honor, they were reporting ordinary income from that property, from sales.

The Court: All right.

Mr. Altman: But the disposition must have taken place later.

The Court: All right.

Mr. Altman: In a later year.

Q. Am I correct?

A. I believe it did.

• • • • • • •

[fol. 247] COMMENTS BY COURT

The Court: This doesn't seem like a very complicated case to me, gentlemen. The question that I want you to give me some authorities on, if you can find them,—it [fol. 248] appears to me this question breaks down to about this:

I think there was a dispute and I think that probably was the reason this property was sold. But I think the intent and purpose of purchasing it was to develop it.

But when you are in the business of developing real estate, let's say, and something comes up, whether it be, let's say, in this case a dispute of the partnership that owns it, can you then sell the property without the development and turn it into a long-term capital gain?

It seems to me there are some hazards in doing business, and when you buy property for development, why, there are certainly some hazards you have to anticipate that can occur. Failure to get zoning, failure to get a mortgage—failure to get financing and you can hold it for that, hoping things change.

But if a dispute between partnerships comes up, is that reason for sale of the property? It may be a reason for the sale, but does that make it, shall we say, necessary to sell it so that you can turn it into a long-term capital gain?

If that is the law, why, partners having a situation that may not be too good can have disputes and sell it and immediately they have a long-term capital gain, and it would not be then in the regular course of business.

Now, although property is sold, outside of development, [fol. 249] for the purpose of the purchase was developed—and I think it was in this case—if it is sold and is not developed it could well be there are some hazards in the business. You can't just say, "Well, I had to sell it because we had a dispute and therefore there is a long-term capital gain."

That is what I want you to try to give me some cases on, a situation where the purpose of the purchase was development or some other purpose, and that something like a dispute between partners arose.

You see, that doesn't strike me as taking the matter out of the ordinary course of business, because these things are likely to happen in the ordinary course of business, and there are some hazards you must assume in the ordinary course of business. Whether this is one I am not saying, I don't know.

* * * * * * *

[fol. 251] The Court: That is the way it appears to me, that the facts in this case wind up. They purchased it with the intent of developing it. They didn't develop it and the reason they didn't is because of this dispute.

Now, I am satisfied that the mortgage problem and the zoning problem had something to do with it, but they could have held it and I think they probably would have held it, but the reason here, I think, was the dispute. They wanted to get rid of it and they didn't want to fool with it any more and have these complications.

But that still doesn't convince me that it was not a sale in what we would have to term the ordinary course of business, even though it violated the purpose, because I think in doing business you have to assume some hazards of doing business. There is some risk in doing business.

• • • • • • •

[fol. 255]

IN THE UNITED STATES DISTRICT COURT

[Title omitted]

Reporter's Transcript of Proceedings—April 6, 1964

[fol. 256] Appearances: Same.

[fol. 259] COURT'S COMMENTS ON OPINION

The Court: The whole basis of my decision, I think you can tell from my memorandum, is that I felt this property was purchased with a double-edged idea and with a double-edged intent and purpose, the purpose being that they would develop it if they could get the changes, the rezoning changes, and the financing, and if they couldn't they would sell it in bulk. Now, that was the basis of my holding.

• • • • • • •

[fol. 291]

IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CENTRAL DIVISION

No. 63-169-EC

WILLIAM MALAT and ETHEL MALAT, Plaintiffs,

vs.

ROBERT A. RIDDELL, etc., Defendant.

REPORTER'S CERTIFICATE

I, Virginia K. Wright, hereby certify that I am a duly appointed, qualified and acting official court reporter of the United States District Court for the Southern District of California.

I further certify that the foregoing 290 pages are a true and correct transcript of the proceedings had in the above-entitled cause on February 17, 20, and April 6, 1964, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Los Angeles, California, this 21st day of July 1964.

Virginia K. Wright, Official Reporter.

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IN THE

Supreme Court of the United States

October Term, 1965
No. 487

WILLIAM MALAT and ETHEL MALAT,

Petitioners,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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IN THE

Supreme Court of the United States

October Term, 1965
No. .....

WILLIAM MALAT and ETHEL MALAT,

Petitioners,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners hereby petition this Court for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit.

Opinions Below.

The memorandum opinion, findings of fact and conclusions of law of the District Court [R1. 9-29] are unreported. The opinion of the Court of Appeals [R1. 44-50; Appendix, *infra*] is reported at 346 F. 2d. .....

Jurisdiction.

The judgment of the Court of Appeals was entered on May 27, 1965 [R1. 51]. The jurisdiction of this Court is based on 28 U.S.C. §1254(1).

Questions Presented.

This is a federal income tax case. A joint venture in which petitioner had an interest acquired land for development into property to be held for rental income. Failure to obtain adequate financing under one plan, and adequate financing and rezoning under a second plan, was followed by a split of the joint venturers into two irreconcilable factions, and this in turn resulted in a sale by one faction of their interests. In form the sale was a sale of the real estate by the joint venture, in part to the two members making up the other faction, and in part to a business associate of one of them. The petitioner, whose joint venture interest was in the selling faction, reported his share of the gain from the two sales as capital gain on his income tax return. That the required financing and rezoning might not be obtained was possibility of which the venturers were aware at the time of acquisition. The questions presented are:

(1) Whether property acquired by a joint venture to be developed and held for rental income, but sold, as a result of a split among the venturers, by one faction to another faction and a third party, constitutes property held by the joint venture primarily for sale to customers in the ordinary course of trade or business.

(2) Whether the term "held primarily for sale," as used in Section 1221(1), Internal Revenue Code of 1954, embraces, as a primary purpose, a thought of a taxpayer, at the time of acquisition, that he possibly may have to sell the property if, at some indefinite time in the future, it proves ultimately incapable of development for rental.

(3) Where the taxpayer's actual intent to sell arises for the first time when he enters into an agreement to sell, the property not having been previously offered or otherwise held for sale, directly or indirectly, to anyone, is the property then held primarily for sale to customers in the ordinary course of trade or business within the meaning of Section 1221(1).

Statutes Involved.

Internal Revenue Code of 1954.

Sec. 1221. Capital asset defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; . . .

Statement.

Petitioner William Malat, hereinafter referred to as "taxpayer," was a member of Louis Lesser Enterprises, Ltd., a partnership, hereinafter referred to as "Lesser." The nature of Lesser's business was, as the court below characterized it, "primarily that of development of real estate for rental."

In 1953 Lesser and four individuals acquired a parcel of land for development for rental income. At the outset they had in mind a single-mortgage development, requiring no division of the property into separate par-

cels. They secured the necessary zoning changes but failed to get adequate financing. In this respect, as the court below put it, they first sought the assistance of the Federal Housing Administration but found that they could not secure FHA guarantees on terms acceptable to them. They next sought conventional financing. Their efforts, through mortgage brokers and savings and loan associations, failed.

The venturers then changed their plan from a single-mortgage project to individual 4-, 6-, and 8-unit apartment buildings, each one with a separate mortgage, but only on an inner parcel of the land, the frontage parcels, two of them, being reserved for commercial use. A map for that purpose covering the inner parcel was filed and approved. However, the rezoning of the frontages for commercial use could not be secured. Also, despite all efforts, the venturers were still unable to secure financing.

They were now faced with interest charges on their trust deed and with the cost of street improvements and like expenses. They thereupon proceeded to sell the apartment lots in the inner parcel. The gain which the venturers realized on those sales is not here involved. Our sole concern is with the gain realized on the sale of the two frontage parcels.

These frontage parcels were retained by the joint venture, still in hope that commercial zoning could be secured as to them. The prospects of rezoning remained discouraging and a rift developed among the venturers. Two of the individuals wanted to get out, while the other two wished to hold on.

Lesser joined with the individuals who wanted to get out. As the trial court found, the rift "resulted in acri-

mony which made further business relations as partners unpleasant." [R1. 27]. Eventually those who wished to get out, including Lesser, sold out their interests. The sale took the form of a sale of the property by the joint venture, in part to the two individuals who wished to remain [R1. 27-8], and in part to a business associate of one of them [R1. 28; R3. 133, lines 10-12].

Immediately at the close of trial the trial court summarized its view of the evidence as follows [R3. 251, lines 1-15]:

> "The Court: That is the way it appears to me, that the facts in this case wind up. They purchased it with the intent of developing it. They didn't develop it and the reason they didn't is because of this dispute.
>
> Now, I am satisfied that the mortgage problem and the zoning problem had something to do with it, but they could have held it and I think they probably would have held it, but the reason here, I think, was the dispute. They wanted to get rid of it and they didn't want to fool with it any more and have these complications.
>
> But that still doesn't convince me that it was not a sale in what we would have to term the ordinary course of business, even though it violated the purpose, because I think in doing business you have to assume some hazards of doing business. There is some risk in doing business."

In regard to the thoughts of the venturers at the time of acquisition of the property, as to what they would do if they should fail to get the zoning and financ-

ing they needed for development for rental, the trial court made the following finding [R1. 26, lines 4-8]:

> "The venturers realized that they had made a good purchase price-wise and, if they were unable to obtain acceptable construction financing or rezoning from 'R-3' to 'C-2' which would be prerequisite to Commercial development, they would sell the property in bulk *so they wouldn't get hurt.*" (Italics supplied.)

Such a sale because of failure to obtain acceptable financing or rezoning was, as testimony recited by the court below showed, "always a possibility in real estate development".

The trial court, on the basis solely of the aforementioned possibility of sale by the venturers "so they wouldn't get hurt", included, as one of its conclusions of law, a statement that the property was held for "development or sale, depending on which course appeared to be most profitable." [R1. 28, lines 28-29]. The trial court also attempted to buttress that conclusion of law by including a finding to the same effect. Proceeding from that conclusion, it reached its final result—that the holding was "primarily for sale to customers in the ordinary course of trade or business"—by relying on the meaning of the term "primarily" announced by the court below in *Rollingwood Corporation v. Commissioner,* 190 F. 2d 263 [R1. 28, lines 23-27].

In the *Rollingwood* case the court below had defined the term "primarily" to mean "essential" or "substantial", 190 F. 2d at page 266. Herein the court below, sustaining the trial court on the basis likewise of *Rollingwood,* applied the term "primarily" as meaning that there could be a "dual purpose", which it ex-

plained as two or more purposes "all of which were substantial reasons" for which the property was held.

The court below, in the course of applying the *Rollingwood* view herein, referred to the case of *Municipal Bond Corporation v. Commissioner,* 341 F. 2d 683, with the notation, "Cf." In the latter case, decided February 18, 1965, the Eighth Circuit reversed the Tax Court, 41 T.C. 20, which had expressly, page 29, relied on the *Rollingwood* view. As the conclusion of its reasoning, however, the court below herein seemed to escape into a different position; for it said, as to the two sales herein involved, that "when taxpayer resolved to sell," that purpose, to sell, "*became* the primary purpose" (Italics supplied).

Reasons for Granting the Writ.

1. The principal reason for granting the writ consists of a direct conflict of the circuits on the meaning of the phrase "held primarily for sale" as used in I.R.C. 1954 (28 U.S.C.) §1221(1). In that conflict, directed particularly to the word "primarily", the court below and the Second Circuit (*S.E.C. Corp. v. U.S.,* 140 F. Supp. 717, 719, affirmed per curiam, 241 F. 2d 416) range on one side, and the Eighth Circuit (*Municipal Bond Corporation v. Commissioner,* 341 F. 2d 683) and the Sixth (*Gotfredson v. U.S.,* 303 F. 2d 464, 468) on the other.

The position of the court below, and of the trial court, is that the property involved was held for a "dual purpose", by which it meant two purposes, one being development for rental income, and the other, sale to customers in the ordinary course of trade or business. The factual base for the latter purpose is solely the

awareness of the venturers, at the time of acquisition of the property, of the possibility that the requirements for development for rental income could not be fulfilled, in which case they would sell the property in bulk "so they wouldn't get hurt". The court below sustained the trial court's treatment of that possibility as an additional purpose in order to bring the case within the doctrine of *Rollingwood Corporation v. Commissioner,* C.A. 9, 190 F. 2d 263.

Accordingly to *Rollingwood,* what the term "primarily" in the statutory provision involved here means (taking in lieu of the adverb, "primarily", the adjective, "primary") is not "principal," but "essential" or "substantial." The Second Circuit, *S.E.C. Corp. v. U.S., supra,* agreed. The Eighth Circuit, however, on February 18, 1965, in *Municipal Bond Corporation v. Commissioner, supra,* at page 687, expressly and necessarily rejected that view, holding the term to mean instead "of first importance or principally." On May 27, 1965, just a week after the time for filing a petition for certiorari in that case expired, the court below rendered its decision herein, following the *Rollingwood* case.

The *Municipal Bond Corporation* case involved, as here, real estate, and, aslo as here, awareness by the taxpayers of a possibility of eventual sale. The Eighth Circuit there cited in its support the following: *Benitez v. Bank of Nova Scotia,* C.A. 1, 125 F. 2d 523; *McCaugh v. Electric Storage Battery Co.,* C.A. 3, 63 F. 2d 715, 717; *Bowles v. Nelson-Ricks Creamery Co.,*

D. Idaho, 66 F. Supp. 885, 888; *In re Day's Estate,* E.D. Ill., 10 F. Supp. 229, 231; *Friedman Textile Co. v. Northland Shopping Center, Inc.,* 321 S.W. 2d 9, 15; *State v. Erickson,* 182 N.W. 315, 317; also Webster's New International Dictionary and Bouvier's Law Dictionary. The Eighth Circuit there also challenged the entire notion of "dual purpose," citing the decision of the Sixth Circuit in *Gotfredson v. U.S., supra.* The latter case, at page 468, stated:

> "The trial court in instructing the jury with regard to 'dual purpose' took away from the jury the issue concerning the essential primary purpose for which the appellants herein held the cattle."

2. A second reason for granting the writ is another direct conflict of the court below, this one not only with other circuits, but also with itself. The court below herein said [R1. 50] that "when taxpayer resolved to sell . . . that purpose became the primary purpose." But it had previously been held that it is the purpose of holding, not the actual sale, which governs; that if the actual sale governed there could never be a capital gain. So the Fifth Circuit clearly held, in *United States v. Bennett,* 186 F. 2d 407, 410-411. So the Eighth Circuit did in *Municipal Bond Corporation v. Commissioner, supra,* at page 689. So, indeed, the court below did in *McGah v. Commissioner,* 210 F. 2d 769, at page 772. See also 3B Mertens §22.138, pp. 628-629. And the trial court herein, in its summary at the close of trial quoted above, stated that the sale here not only did not conform to the purpose, but that it *violated* the purpose.

Nor does awareness of the possibility of sale "so they wouldn't get hurt" creat a distinction. Such awareness appeared in both the *Bennett* and *Municipal Bond* cases cited above. Indeed, in the case here the court below itself observed, as noted in our "Statement" above, that in real estate development there was *always* the possibility that the requirements for development could not be fulfilled and the necessity of sale result.

3. Another reason for granting the writ is a conflict with decisions of this court and other circuits on another point. The conclusion of "dual purpose" herein—to hold "for development or sale, depending on which course appeared to be most profitable"—is not a finding drawn from the evidence; it is, in fact, clearly contrary to the evidentiary finding that if the necessary rezoning or financing could not be obtained the venturers would sell the property in bulk so they wouldn't get hurt. A purpose to sell if that is "most profitable" is in no way the same as a purpose to sell "so they wouldn't get hurt." Indeed, the two ideas are inconsistent. Thus the "dual purpose" conclusion here, if treated as a finding, is not one drawn from the evidence, but one induced by a view of the law, and therefore not a part of the facts at all. As a result the decision below is in conflict with the decision of this court in *United States v. U.S. Gypsum Co.*, 333 U.S. 364, 394. It would also not be at all far-fetched to contend that this clear *non sequitur* is such a gross violation of simple logic as to constitute a violation of due process. *Tot v. United States*, 319 U.S. 463, 467,

63 S. Ct. 1241, 1245; *Colon-Rosich v. People of Porto Rico* (C.A. 1), 256 F. 2d 393, 397-8.

4. We submit also that the meaning attributed by the court below to the word "primarily" as used in the statutory provision involved is in conflict with ordinary business sense. We quote from the analysis of the opinion below in the familiar tax service of Rabkin & Johnson, in their Federal Taxation Report No. 276, July, 1965, as follows:

> "This decision erodes dangerously the mandate of the Code that the property be held 'primarily' for sale. Any sensible investor, prior to purchase, must consider the possibility that his investment will not prove up to expectation. If he is as fortunate as this taxpayer and knows that he has made a good purchase in any event, he is now relegated to ordinary income under this unrealistic rule of the Ninth Circuit."

5. A final reason for granting the writ is the importance of the issues involved in the administration of the revenue. As the citator of the Federal Reporter series shows, the case relied on herein by the court below, and from which the conflicts above cited stem, that is, *Rollingwood v. Commissioner, supra,* has been cited in connection with the points involved here in a long list of cases. It has so been cited in opinions of the courts and in dissenting opinions. It has been followed, it has been distinguished, it has been questioned, and it has been rejected. The situation is now one of such chaos that it can only be cleared up by a

decision of this Court. Moreover, the terms involved are still in the statute. Thus, the issue still remains as one of importance in the administration of the income tax, and not only for earlier, but for current taxable years. *The Colony, Inc. v. Commissioner,* 357 U.S. 28, 32.

Wherefore, petitioners pray that this Court issue the writ of certiorari sought herein to the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

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APPENDIX.

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

William Malat and Ethel Malat, Appellants, vs. Robert A. Riddell, District Director of Internal Revenue, Appellee. No. 19,286.

[May 27, 1965]

On Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Merrill, Duniway and Ely, Circuit Judges.

Merrill, Circuit Judge:

Profit derived from sales of property held by a taxpayer, primarily for sale to customers in the ordinary course of his trade or business, is, under section 1221 of the Internal Revenue Code of 1954,[1] excluded from treatment as capital gain.

This case presents the question whether real estate sold at a profit by one engaged in the business of dealing in real estate had, under the particular circumstances, been held by him as an investment or primarily

---

[1]Section 1221, Internal Revenue Code of 1954, reads:

"Sec. 1221. Capital asset defined.

For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; * * *."

for sale to customers. Upon this issue the trial court has found against the taxpayer, ruling that the profit must accordingly be treated as ordinary income. We conclude that the District Court's finding is not clearly erroneous and affirm.

The case involves income tax for the year 1956. The taxpayer[2] had reported the gain on the transaction in question as capital gain. The Internal Revenue Service disagreed. A deficiency was assessed and was paid by the taxpayer. This suit for recovery followed.

Taxpayer at all times pertinent to this case was a member of Louis Lesser Enterprises, Ltd., a partnership (to which we shall refer as "Lesser"), which for some time as a business enterprise had been engaged in the purchase and development of real estate for rental.

In 1953 Lesser and four individuals not members of the partnership negotiated for the purchase of 44.901 acres of agricultural land, located at Century and Crenshaw boulevards in Inglewood, California. On August 12, 1953, they organized Century-Crenshaw Plaza as a joint venture, entered into agreement for purchase of the property for the sum of $486,000 and established an escrow for that purpose. At the time of the establishment of the escrow the land was zoned agricultural. A condition to the closing of the escrow was that it be rezoned as residential, and that a corner parcel retained by the seller, 600 x 600 feet, be rezoned as commercial. These changes in zoning were accomplished and the escrow was closed on February 15, 1954.

In the meantime the intentions of the venturers with respect to the land had undergone a series of changes.

---

[2]William Malat is referred to as the taxpayer. His wife is joined since a joint return was filed.

At the outset, as taxpayer testified, they "had in mind" a garden-type apartment development of the entire property—a single-mortgage development, requiring no division of the property into separate parcels. This was contingent not only on their securing zoning changes (in which they were successful) but (since they were themselves in no position to finance the project) also on their ability to secure adequate financing. In this respect they first sought the assistance of the Federal Housing Administration but found that they could not secure FHA guarantees on terms acceptable to them. They next sought conventional financing. Their efforts, through mortgage brokers and savings and loan associations, failed. As taxpayer testified, "The mortgage market was very, very soft then, very tight." They then abandoned their original idea of a single-mortgage project. Taxpayer testified: "Our next thought was to build individual apartments, 4-, 6-, 8-unit buildings and finance each one with a separate mortgage." This involved carving out an inner parcel of 20 to 25 acres for the apartment buildings and retaining the two frontage areas on Century and Crenshaw boulevards for commercial use. A subdivision map covering the inner parcel was presented to the City of Inglewood and approved. For two reasons, this idea also had to be abandoned. The rezoning of the frontages could not be secured. Also, despite all efforts, the venturers were still unable to secure financing.

They were now faced with interest charges on their trust deed and with the cost of street improvements and like subdivision expenses. Taxpayer testified "So we took the next best route, * * * and proceeded to sell the lots, the individual lots in the subdivision." The

frontage parcels were retained, still in hope that commercial zoning could be secured as to them. The prospects of rezoning remained discouraging and a rift developed among the venturers; Lesser and two individuals "wanted to get out and be done with it." The other two wished to hold on. Eventually those who wished to get out, including Lesser, sold out their interests.

The gain which the venturers had realized on sale of the subdivision lots had been reported as ordinary income and is not here involved. Our sole concern is with the gain realized on the sale of the two frontage parcels.

Taxpayer contends that at no time had the venturers ever contemplated sale of these parcels until the rift among them brought about a change of plans; that at all times these parcels had been held for future development for the production of income; that when the subdivided lots had been sold the frontages were withheld from sale pursuant to original intent.

The Government contends that the prospect of sale was present from the outset, and constituted a primary purpose of the holding at the time of the sale. It points to the following testimony of taxpayer:

> "Q: Mr. Malat, at the time that you were considering the zoning potential and the development potential of this property, did you contemplate, in acquiring the property, the possibility that rezoning or refinancing, or whatever, might not be possible?
>
> A: This is always a possibility in real estate development
>
> Q: And what was your intention if that couldn't—I mean, you must have considered this as well.

A: Well, this was a bridge that we all felt we would cross when we came to it. We would first do the things—we felt that we had made a good buy on the property as far as price is concerned, so that if we couldn't do anything in the way of zoning, we would sell the whole thing off in bulk. We wouldn't get hurt. So, there was no urgency. There was no need to say, 'Well, if this doesn't happen, and that doesn't happen—' we took one step at a time."

The District Court, in its memorandum opinion, stated:

"It appears from the testimony of plaintiff read into evidence from his deposition, referred to above, that the property here in question was purchased with the thought in mind that if the rezoning or appropriate financing could not be accomplished that the parties 'would sell the whole thing off in bulk. We wouldn't get hurt.' "

And further:

"The rift between the partners may have expedited the sale but it appears that the failure to obtain rezoning and satisfactory financing was the primary cause of the sale which was the step intended by the parties to be taken at the time the property was acquired and while it was held, if the rezoning and financing failed. In other words, the property was purchased and held for development *or sale* depending on which course appeared to be most profitable, having in mind the need for rezoning and the availability of proper financing on reasonable terms."

The court concluded that at the time of sale of the frontages the properties were held with a dual purpose; that sale of the properties was an essential purpose. Relying on *Rollingwood Corporation v. Commissioner,* 190 F.2d 263 (9th Cir. 1951), it held taxpayer not entitled to capital-gain treatment.

Taxpayer seeks to distinguish *Rollingwood* on the ground that there the dual purpose was clearly fixed in a lease-or-option arrangement to which taxpayer was committed. Here, he asserts, the only "dual purpose" lies in his recognition, wholly consistent with investment, that sale might ultimately be felt to be more desirable financially than a continued holding for investment. Cf., *Municipal Bond Co. v. Commissioner,* 33 U.S.L.Week. 2465 (8th Cir. 1965).

We quite agree with taxpayer that an investor's prospective recognition of the fact that he may ultimately wish to realize on his investment is not enough to constitute sale a dual purpose of the holding. *Rollingwood* does not require such a result. We cannot agree with taxpayer, however, that this is such a case.

In such a case as this the purpose of the holding is undoubtedly difficult of ascertainment. Where an investment program has been followed through, it is there for all to see. Where it has been frustrated at the outset and resort is had to sale, the purpose of the holding at the time of sale is far more questionable. Was the sale a liquidation of an investment whose prospects had proved disappointing? To put the question another way, was it the exercise of a purpose *not* to hold rather than of a purpose to hold for sale?

In our judgment the answer in such a case must be found in the scope of the gain-producing purpose for

which the property was acquired and held. Two situations may be hypothesized to illustrate what we mean.

(1) If the purpose for which the property was acquired and held was solely and specifically to develop for rental; if it excluded the realization of gain other than in that fashion; and if such purpose was accompanied by an intent to liquidate (irrespective of consequent gain or loss) if this purpose failed, then a sale pursuant to such a program might well be regarded as nothing more than liquidation of a disappointing investment.

(2) If, however, the property was acquired and held with the purpose of realizing gain from it in any feasible manner which might present itself; if the owner stood ready to adapt his program to such changes as failing prospects might require and to realize gain wherever and however he could; then surely the realization of gain by sale is pursuant to the purpose of the holding. The taxpayer in such a case could be said throughout the course of his holding to have had several alternative purposes (all of which were substantial reasons for his holding within the *Rollingwood* definition of "primary"), each of which in turn actually became the primary purpose as efforts were concentrated in its direction.

The nature and extent of the gain-producing purpose is, of course, a factual issue. Whether in a particular case it falls on the investment-limited side of the line or on the all-encompassing side is a question of fact.

The District Court in substance has found that the scope of the taxpayer's intent was all-encompassing.[3]

[3]The District Court has found as fact that "The members of Plaza, as of the date the 44.901 acres were acquired, intended

In our judgment the record amply supports that finding.

In this connection we note first that it must be recognized that in the case of one who deals generally in real estate the rational inference is that the purpose of the holding was all-encompassing. The dealer is, after all, in the business of acting in precisely that fashion. Where an avowed purpose to invest (rather than hold for sale) has failed to materialize, the real estate dealer thus has a burden to meet in overcoming the inference that upon failure of the investment prospect the property sold had threreafter been held primarily for sale to customers in the ordinary course of his trade or business. See *Margolis v. Commissioner,* 337 F.2d 1001 (9th Cir. 1964).

While the nature of taxpayer's business was primarily that of development of real estate for rental, and he might therefore dispute the rationality of such an inference in this case,[4] still, the history of his holding provides ample support for the court's finding. That history demonstrates the many possibilities of gain possessed by the property (including subdivision and sale) which were in turn explored by the owners. At the outset taxpayer realized that the original plan might not work out. He would, he testified, cross that bridge when he came to it—take one step at a time.

Certainly it may be said (as the District Court in effect has said) that the purpose of the acquisition en-

---

either to sell the property or develop it for rental, depending upon which course appeared to be the most profitable."

[4]It does not appear that the nature of the business of the joint venture, or of the venturers with whom taxpayer was there associated, was so limited. The inference may thus still retain its rationality as to this particular venture of the taxpayer.

compassed all of the steps which were successively taken, and that the primary purpose of the holding touched on each in turn. Sale, then, was not the liquidation of an investment. It was the final alternative in taxpayer's continuing efforts to realize gain from his acquisition. It was *part* of his plan rather than the abandonment of it.

Under these circumstances, when taxpayer resolved to sell, that purpose (which from the time of acquisition had been one of many alternative essential purposes) became the primary purpose and the property was primarily held for the purpose of sale.

Judgment affirmed.

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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 487

WILLIAM MALAT AND ETHEL MALAT, PETITIONERS

v.

ROBERT A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-9) is reported at 347 F. 2d 23. The memorandum opinion and conclusions of law of the district court (R. 9-29)[1] are not officially reported.

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[1] "R." refers to Vol. I of the original transcript of the record in the district court. "Tr." refers to the transcript of the proceedings contained in Vols. II and III of the record in the district court. All three volumes have been filed with the Clerk of this Court.

JURISDICTION

The judgment of the court of appeals was entered on May 27, 1965 (R. 51). The petition for a writ of certiorari was filed on August 23, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the lower courts correctly ruled that certain property was held primarily for sale to customers in the ordinary course of business and, accordingly, that the taxpayer's[2] profit from the sale of the property is taxable as ordinary income rather than as capital gain.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 61. GROSS INCOME DEFINED.
>
> (a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, and similar items;
>
> (2) Gross income derived from business;

---

[2] For convenience William Malat is referred to as "taxpayer", although his wife, Ethel Malat, is also a petitioner by reason of having filed a joint return with her husband for the 1956 tax year.

(3) Gains derived from dealings in property;

* * * *

(26 U.S.C. 61.)

SEC. 702. INCOME AND CREDITS OF PARTNER.

* * * *

(b) *Character of Items Constituting Distributive Share.*—The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

* * * *

(26 U.S.C. 702.)

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * * *

(26 U.S.C. 1221.)

SEC. 1222. OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES.

For purposes of this subtitle—

* * * *

(3) *Long-Term Capital Gain.* — The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

* * * *

(26 U.S.C. 1222.)

STATEMENT

The facts are set forth in detail in the findings of the district court (R. 23-28), and may be summarized as follows:

During the taxable year 1956 the taxpayer was a general partner of Louis Lesser Enterprises, Ltd. ("Lesser"), a partnership. Lesser, in turn, was a partner with four individuals in Century Crenshaw Plaza ("Plaza"), in which each partner had a 20 per cent interest in capital, profits and losses. In 1954 Plaza acquired for $486,000 a parcel of real estate in Inglewood, California (R. 24-25).

The land originally had been zoned for agricultural purposes, but prior to the acquisition it had been rezoned for multiple residential dwellings. When Plaza acquired the property, the partners intended either to sell it or to develop it for rental, depending on which course appeared to be most profitable. They realized that they had made a good pur-

chase price-wise, and that if they were unable to obtain acceptable construction financing or rezoning for commercial purposes, they could sell the property in bulk so that they "wouldn't get hurt." Plaza continued to have this purpose of either selling or developing the property as long as it held the land (R. 25-26).

The development of the property as a multiple residential project was contingent on obtaining financial guarantees by the Federal Housing Administration, which could not be secured on terms acceptable to Plaza. Plaza was unable to develop commercially the frontage property along two sides of the tract and to develop the remainder into a multiple residential project, since it could not obtain the necessary conventional financing necessary for the apartment project and could not secure a zoning change for the frontage property (R. 26).

After Plaza had failed to obtain rezoning or acceptable financing, a rift arose among the partners, which made further business relations unpleasant (R. 26-27). Plaza then subdivided part of the land into individual lots, which it sold. Both Plaza and its partners reported the gains from such sale as ordinary income.

After it sold the individual lots, Plaza sold the frontage property, and reported its profits therefrom as long-term capital gains. Lesser (one of the partners of Plaza) in turn treated on its partnership information return its distributive share of such profits as capital gains, and the taxpayer similarly

treated his distributive share of the gains reported by Lesser (R. 27-28, Exs. A and B, Tr. 138).

The Commissioner ruled that the profits on the sale of the two frontage tracts were ordinary income rather than capital gain. The district court upheld this ruling. It found that Plaza held the property either for development or for sale, depending on which appeared to be most profitable, and that the taxpayer had failed to establish that the property was not held by Plaza primarily for sale to customers in the ordinary course of its trade or business (R. 28-29). The court of appeals affirmed, holding that the record supports the district court's finding that the property was held primarily for sale (Pet. App. 1-9).

ARGUMENT

Section 1221(1) of the Internal Revenue Code of 1954 (*supra*, p. 3) specifically excludes from the category of capital assets, the profits on the sales of which are treated as capital gain rather than as ordinary income, "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Whether particular property is so held is largely a factual question, in the determination of which no single factor is controlling. Thus, the decision of this issue lies primarily within the discretion of the trial court, and its conclusion is not to be disturbed unless clearly erroneous.[3] In the present case, the district court found

[3] See, e.g., *Yara Engineering Corp.* v. *Commissioner*, 344 F. 2d 113 (C.A. 3); *Margolis* v. *Commissioner*, 337 F. 2d 1001 (C.A. 9); *Ackerman* v. *United States*, 335 F. 2d 521

that Plaza held the two frontage parcels primarily for resale, and the court of appeals upheld that finding as having adequate evidentiary support. This Court repeatedly has declined to review the factual determination that particular property was held primarily for sale,[4] and there is similarly no occasion for further review of that narrow issue here.

In any event, the evidence supports the trial court's finding that Plaza held the property primarily for sale to customers. Although the participants in

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(C.A. 5); *Coffey* v. *United States*, 333 F. 2d 945 (C.A. 10); *Broughton* v. *Commissioner*, 333 F. 2d 492 (C.A. 6); *Wineberg* v. *Commissioner*, 326 F. 2d 157 (C.A. 9); *Recordak Corp.* v. *United States*, 325 F. 2d 460 (Ct. Cl.); *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992; *Los Angeles Extension Co.* v. *United States*, 315 F. 2d 1 (C.A. 9); *Bauschard* v. *Commissioner*, 279 F. 2d 115 (C.A. 6); *Harry Slatkin Builders* v. *Commissioner*, 235 F. 2d 189 (C.A. 6), certiorari denied, 352 U.S. 928; *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 (C.A. 9); *Harriss* v. *Commissioner*, 143 F. 2d 279 (C.A. 2). Indeed, the taxpayer here strongly asserted in the district court that the issue was factual (Amended Pre-trial Conference Order, par. VIII, R. 7).

[4] See, e.g., *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992; *American Can Co.* v. *Commissioner*, 317 F. 2d 604 (C.A. 2), certiorari denied, 375 U.S. 993; *S.E.C. Corp.* v. *United States*, 241 F. 2d 416 (C.A. 2), affirming *per curiam*, 140 F. Supp. 717 (S.D. N.Y.), certiorari denied, 354 U.S. 909; *Harry Slatkin Builders* v. *Commissioner*, 235 F. 2d 189 (C.A. 6), certiorari denied, 352 U.S. 928; *Shearer* v. *Smyth*, 221 F. 2d 478 (C.A. 9), certiorari denied, 350 U.S. 840; *Rubino* v. *Commissioner*, 186 F. 2d 304 (C.A. 9), certiorari denied, 342 U.S. 814; *King* v. *Commissioner*, 189 F. 2d 122 (C.A. 5), certiorari denied, 342 U.S. 829.

Plaza originally hoped to develop the entire property as a garden-type apartment, they recognized that such development was contingent upon obtaining the necessary rezoning and adequate financing, and they always intended that, if such rental development turned out either to be impossible or to be less profitable than sale, they would sell the property. As the court of appeals noted (Pet. App. 4-5), the taxpayer himself testified, in response to the question whether he "contemplate[d] * * * the possibility that rezoning or refinancing, or whatever, might not be possible?" that

> * * * we felt that we had made a good buy on the property as far as price is concerned, so that if we couldn't do anything in the way of zoning, we would sell the whole thing off in bulk. We wouldn't get hurt.

On the basis of this testimony, the district court concluded (Pet. App. 5) that the property "was purchased with the thought in mind that if the rezoning or appropriate financing could not be accomplished that the parties 'would sell the whole thing off in bulk. We wouldn't get hurt.' "

Thus, as the court of appeals ruled (Pet. App. 7-9), "the property was acquired and held with the purpose of realizing gain from it in any feasible manner which might present itself"; "the many possibilities of gain possessed by the property (including subdivision and sale) * * * were in turn explored by the owners"; and when the property finally was sold, it was "not the liquidation of an investment" but "the final alternative in taxpayer's

continuing efforts to realize gain from his acquisition." Where property is so held for the express purpose either of selling it or of retaining it for development—and the possibility of sale is not merely the implicit recognition that if the investment should prove unattractive, it would be liquidated—it is "held * * * primarily for sale to customers" within the meaning of Section 1221(1) of the Code. *Recordak Corp.* v. *United States*, 325 F. 2d 460 (Ct. Cl.); *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992; *Greene-Haldeman* v. *Commissioner*, 282 F. 2d 884 (C.A. 9); *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 (C.A. 9).

2. Contrary to petitioners' contention (Pet. 7-9), the decision below does not conflict with either *Gotfredson* v. *United States*, 303 F. 2d 464 (C.A. 6), or *Municipal Bond Corporation* v. *Commissioner*, 341 F. 2d 683 (C.A. 8). In *Gotfredson* an instruction that the jury should hold for the government if it found that cattle were held for the dual purpose of breeding and sale was held erroneous not on the ground that the dual purpose theory was wrong, but that there was no evidence there of such purpose. In the present case, however, both courts below found as a fact that there was a dual purpose. Indeed, subsequent to *Gotfredson* the Sixth Circuit apparently approved the dual purpose theory. See *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198, 200 (C.A. 6), certiorari denied, 375 U.S. 992.

In *Municipal Bond*, the Eighth Circuit reversed the Tax Court's finding that the taxpayer held real

estate primarily for sale. It held that the Tax Court had misconstrued "primarily" to mean "substantially"—a construction which the Tax Court stated "permits recognition of the dual purpose concept inherent in some types of business operations" (see 341 F. 2d at 687); and that the Tax Court had erred because it "did not base its findings and decision on a determination of the primary or predominant purpose of taxpayer in acquiring and holding the various properties" (p. 690). It is by no means clear, however, that the Eighth Circuit would reject the trial court's finding in the present case that the taxpayer held the property "primarily" for sale, where two purposes were equally important at the outset and, as the trial court in effect found, the sale purpose subsequently became "primary or predominant." Since the application of the statutory phrase turns so largely upon an evaluation of all the pertinent facts, there is no occasion to resolve any possible conflict with the Eighth Circuit unless and until the latter makes it unmistakably clear that no factual situation whatever could justify the dual purpose theory.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER, 1965.

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No. 487

WILLIAM MALAT and ETHEL MALAT,

Petitioners,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue,

Respondent.

Petitioners' Reply Brief.

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Petitioners' Reply Brief.

Respondent points out no inaccuracy or omission in the Statement given in the petition, but writes his own completely separate Statement, thereby ignoring Rule 40-3 of this Court's rules. That separate Statement of his, by omissions and rephrasing, seriously distorts some of the facts. In view of that situation, we urge the Court to use the Statement in the petition instead.

Respondent in his argument similarly distorts the findings and opinions below. Neither court below said, as respondent would have this Court infer (Br. p. 10), that there was a purpose of sale "equally important at the outset" to the purpose of investment. Nor did either court, as respondent implies (Br. p. 10), place a change of purpose anywhere in a broad period of time by saying that the sale purpose "subsequently" became primary

or predominant. What the court below did was to fix the precise point of time by saying that "when taxpayer resolved to sell" that purpose became the primary one. (Pet. App. p. 9). Of course, the statement with that precise point of time defeats itself since, as observed in the petition, p. 9, it is equally true of *all* property, for whatever purpose held; and that, it must be concluded, is why respondent restated it.

Petitioners submit that the Eighth Circuit, in *Municipal Bond Corporation v. Commissioner*, 341 F. 2d 683, held that:

> (1) in determining the primary purpose for which taxpayers held property, all relevant circumstances prior to the time of its disposition must be considered, and
>
> (2) the term "primarily", as used in Section 1221(1) of I.R.C. 1954, does not mean "substantial", or "one of dual purposes".

The opinion of the court below, in the instant case, holds precisely the opposite on both of these points. The conflict does not arise because of, nor is it reconcilable by, nice semantic distinctions.

If the Eighth Circuit's interpretation of Section 1221(1) is correct, then petitioners clearly are entitled to treat the gain on the sale of property involved here as a long-term capital gain. Only by a decision of this court can the palpable conflict of law between the Eighth and Ninth Circuits on the issues stated be resolved.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

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PETITIONERS' OPENING BRIEF.

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1.

The dual purpose finding of the District Court, that the venturers "intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable," is not one drawn from the evidence, but one induced by a view of the law, and is therefore not a part of the facts at all 11

2.

In the context here the term "primarily" means "of first importance or principally;" and property is not "held primarily for sale" where the only thought of sale is the idea of the taxpayer, at the time of acquisition, that he possibly may have to sell the property if, at some indefinite time in the future, it proves ultimately incapable of development for rental 12

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Finally, the Court of Appeals erred in assuming that the actual sales involved here made sale the primary purpose of the holding 17

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Respondent.

PETITIONERS' OPENING BRIEF.

Opinions Below.

The opinion of the District Court [R. 8-17] is not officially reported. The opinion of the court below is reported at 347 F. 2d 23.

Jurisdiction.

This case involves a suit for refund of income taxes. The suit was filed in the United States District Court for the Southern District of California. A judgment of that court dismissing the action was entered April 21, 1964 [R. 25-26]. A notice of appeal to the United States Court of Appeals for the Ninth Circuit was filed May 7, 1964 [R. 26]. A judgment of affirmance by that court was entered May 27, 1965 [R. 35]. A petition for certiorari was filed in this court August 23, 1965. The order allowing certiorari was entered November 8, 1965 [R. 36]. The jurisdiction of this court is based on 28 U.S.C. §1254(1).

Statutes Involved.

26 U.S.C. (Internal Revenue Code of 1954), §1221. Capital asset defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; . . .

Questions Presented.[1]

(1) Whether the finding that the venturers "intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable," can survive in the face of (a) the finding that if the property proves ultimately incapable of commercial development the venturers would sell the whole thing off in bulk so as not to get hurt, and (b) the complete absence of a single word in the record showing an intention to sell for the purpose of profit.

(2) Whether the term "held primarily for sale," as used in section 1221(1), Internal Revenue Code of 1954, embraces an intent of the taxpayer, in connection

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[1]Question 1 above is based on Reason 3 in the Petition for Certiorari beginning therein at page 10, and Question 1 in the Petition for Certiorari is now treated as embraced within Question 2 in that Petition.

with the acquisition of property by him for development for rental, that if the property proved ultimately incapable of such development because of failure to obtain the requisite rezoning or refinancing, he would sell the whole thing off in bulk so as not to get hurt.

(3) Where the taxpayer's intent to sell arises for the first time when he enters into the agreement to make the sale involved, the property not having been previously held for sale, directly or indirectly, to anyone, is the property then held primarily for sale to customers in the ordinary course of trade or business within the meaning of section 1221(1)?

Statement.

In order to avoid burdening this court with an unnecessary recitation of the facts, we adopt as far as it goes, and quote, the following summary of the facts with which the Court of Appeals began its opinion [R. 29-31]:

> "The case involves income tax for the year 1956. The taxpayer[2] had reported the gain on the transaction in question as capital gain. The Internal Revenue Service disagreed. A deficiency was assessed and was paid by the taxpayer. This suit for recovery followed.
>
> "Taxpayer at all times pertinent to this case was a member of Louis Lesser Enterprises, Ltd., a partnership (to which we shall refer as 'Lesser'), which for some time as a business enterprise had

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[2]William Malat is referred to as the taxpayer. His wife is joined since a joint return was filed."

been engaged in the purchase and development of real estate for rental.[2]

"In 1953 Lesser and four individuals not members of the partnership negotiated for the purchase of 44.901 acres of agricultural land, located at Century and Crenshaw boulevards in Inglewood, California. On August 12, 1953, they organized Century-Crenshaw Plaza as a joint venture, entered into agreement for purchase of the property for the sum of $486,000 and established an escrow for that purpose. At the time of the establishment of the escrow the land was zoned agricultural. A condition to the closing of the escrow was that it be rezoned as residential, and that a corner parcel retained by the seller, 600 x 600 feet, be rezoned as commercial. These changes in zoning were accomplished and the escrow was closed on February 15, 1954.

"In the meantime the intentions of the venturers with respect to the land had undergone a series of changes.

"At the outset, as taxpayer testified, they 'had in mind' a garden-type apartment development of the entire property—a single-mortgage development, requiring no division of the property into separate

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[2]In respect to the business of petitioners themselves the memorandum opinion of the District Court contains the following [R. 11]:

"Plaintiffs, in the case at bar, have for a number of years, been engaged in the purchase of property for development as an investment. They have frequently held interests as partners and stockholders in businesses holding properties for development and income where, in isolated cases, a portion of the unimproved real estate was sold as lots or raw land. The evidence shows that such sales were infrequent. The court recalls only three being referred to by plaintiff."

parcels. This was contingent not only on their securing zoning changes (in which they were successful) but (since they were themselves in no position to finance the project) also on their ability to secure adequate financing. In this respect they first sought the assistance of the Federal Housing Administration but found that they could not secure FHA guarantees on terms acceptable to them. They next sought conventional financing. Their efforts, through mortgage brokers and savings and loan associations, failed. As taxpayer testified, 'The mortgage market was very, very soft then, very tight.' They then abandoned their original idea of a single-mortgage project. Taxpayer testified: 'Our next thought was to build individual apartments, 4-, 6-, 8-unit buildings and finance each one with a separate mortgage.[3]' This involved carving out an inner parcel of 20 to 25 acres for the apartment buildings and retaining the two frontage areas on Century and Crenshaw boulevards for commercial use. A subdivision map covering the inner parcel was presented to the City of Inglewood and approved. For two reasons, this idea also had to be abandoned. The rezoning of the frontages could not be secured. Also, despite all efforts, the venturers were still unable to secure financing.

"They were now faced with interest charges on their trust deed and with the cost of street improve-

[3]As to the venturers' objective at this point the same witness testified [R. 49]:

"Well, our objective was the same on an individual building basis, as it was on a project basis, was to develop the property into apartments, apartment buildings that we could keep and collect rents on."

ments and like subdivision expenses. Taxpayer testified 'So we took the next best route, * * * and proceeded to sell the lots, the individual lots in the subdivision.' The frontage parcels were retained, still in hope that commercial zoning could be secured as to them. The prospects of rezoning remained discouraging and a rift developed among the venturers: Lesser and two individuals 'wanted to get out and be done with it.' The other two wished to hold on. Eventually those who wished to get out, including Lesser, sold out their interests.

"The gain which the venturers had realized on sale of the subdivision lots had been reported as ordinary income and is not here involved. Our sole concern is with the gain realized on the sale of the two frontage parcels."

The Court of Appeals then quoted the following testimony of petitioner Malat taken in a deposition by respondent, read into the record by respondent, and pointed to in the Court of Appeals by respondent [R. 31, 116]:

"'Q. Mr. Malat, at the time that you were considering the zoning potential and the development potential of this property, did you contemplate, in acquiring the property, the possibility that rezoning or refinancing, or whatever, might not be possible? A. This is always a possibility in real estate development.

Q. And what was your intention if that couldn't —I mean, you must have considered this as well. A. Well, this was a bridge that we all felt we would cross when we came to it. We would first do the things—we felt that we had made a good

buy on the property as far as price is concerned, so that if we couldn't do anything in the way of zoning, we would sell the whole thing off in bulk. We wouldn't get hurt. So, there was no urgency. There was no need to say, "Well, if this doesn't happen, and that doesn't happen—we took one step at a time." ' "

The above quotation comprises the only evidence, absolutely the only evidence, of any idea of the venturers, at the time of acquisition, that sometime they might sell the property. And even that idea, however it might be framed, disappeared. This the District Court itself brought out, in the course of the trial. This occurred as follows [R. 90-91]:

"By Mr. Bay [for respondent]:

Q. Was it your intention to develop both the Century portion and the Crenshaw portion as commercial, or just the Century portion as commercial? A. No, we had hopes that both parcels could be zoned. They both fronted on major arteries and were susceptible to good commercial development, if the zoning were obtainable.

Q. Well, don't we get down to the basic point, that the only reason you were intending to or the only reason you sold the property was that you were having a rift among the partners because you were holding the property, waiting for the zoning situation—

The Court: That is what he said, I think. He said that was the reason that they sold it, isn't that right?

The Witness: That is the only reason. We could well—

The Court: That was the only reason, they had a dispute.

The Witness: We could well still be sitting with that property waiting to develop it if there had been a rapport among the partners. We weren't pressed for cash."

Also [R. 120]:

"By Mr. Altman [for petitioners]:

Q. Mr. Malat,—

The Court: He says, Mr. Altman, and it is very clear, he said more than once the reason they sold it was because of the acrimony and the dispute and the ill feeling between the partners.

Mr. Altman: Yes.

The Court: That is the reason they sold it. They had this plan and they would have held it and made R-3 if they couldn't get the commercial zoning."

Thus the idea of the venturers, at the time of acquisition, that if their plan for development failed, they would sell the property off in bulk,—even that idea vanished and there was left solely their intention to hold for development.

It is in that factual situation that we come to the two sales involved here. One of them was to the continuing partners, Hicks and Fenmore [R. 23-24], the other was to a business associate of the said Hicks [R. 65-66], and both were made solely at the instance and request of the said Hicks [R. 64-66, 118]. Neither of the courts below said that those sales were sales to customers, or in the ordinary course of business. Indeed, the Court of Appeals interpreted them as in effect

sales of partnership interests, instead of the land itself, saying, as above quoted [from R. 30]: "Eventually those who wished to get out, including Lesser, sold out their interests."

The District Court had, however, on the basis solely of the testimony quoted at pp. 6-7 above as testimony quoted by the Court of Appeals, made the following finding [R. 22]:

> "11. The members of Plaza, as of the date the 44.901 acres were acquired, intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable. The venturers realized that they had made a good purchase price-wise and, if they were unable to obtain acceptable construction financing or rezoning from 'R-3' to 'C-2' which would be prerequisite to commercial development, they would sell the property in bulk so they wouldn't get hurt. The purpose of either selling or developing the property continued during the period in which Plaza held the property."

In the Court of Appeals petitioners did not challenge the second sentence of that finding, as showing an intention of the venturers at the time of acquisition; but they did challenge, as contrary to the record, the first and last sentences thereof, and the District Court's conclusion of law [R. 24] that petitioners had failed to establish that the property was not held by the venturers primarily for sale to customers in the ordinary course of their trade or business.

Summary of Argument.

The finding of a dual purpose, "to sell the property or develop it for rental, depending upon which course appeared to be most profitable," is in conflict with the finding that if the venturers failed to develop the property for rental they would sell it off "in bulk so they wouldn't get hurt." A purpose to sell for profit is also unsupported by a single word in the record. Thus the dual purpose finding is not one drawn from the evidence but one induced by a view of the law, and is not a part of the facts at all.

In the context here, that is, as used in Section 1221 (1) of I.R.C. 1954, the term "primarily" means, in accordance with common usage, "of first importance or principally," and the purpose to develop for rental was, on the basis of the trial court's own evidentiary findings, the purpose "of first importance" here. Indeed, there was here, as the evidence called forth by the trial court itself shows, no holding for sale at all during the period preceding the sales involved.

The actual sales involved here were, in effect, as the Court of Appeals itself viewed them, p. 6, *supra,* sales of partnership interests rather than of the real property itself. Clearly they were neither sales to customers nor in the ordinary course of trade or business. Therefore the resolve to make those sales could not be evidence of a holding primarily for sale to customers in the ordinary course of trade or business. Moreover, if a prior purpose to sell "became" the primary purpose by virtue of that resolve, as the Court of Appeals asserts, it begs the question whether at the time of that resolve sale of any kind to anyone was the primary purpose of the holding.

ARGUMENT.

1.

The Dual Purpose Finding of the District Court, That the Venturers "Intended Either to Sell the Property or Develop It for Rental, Depending Upon Which Course Appeared to Be Most Profitable," Is Not One Drawn From the Evidence, but One Induced by a View of the Law, and Is Therefore Not a Part of the Facts at All.

The finding of an alternative intent to sell for the purpose of profit, contained in the finding that the venturers "intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable," is in clear conflict with the finding, contained in the very same paragraph of the findings, that if financing or rezoning could not be obtained for commercial development the venturers "would sell the property in bulk so they wouldn't get hurt." A purpose to sell if that is "most profitable" is inconsistent with a purpose to sell "so they wouldn't get hurt."

In the second place, the finding of a purpose to sell if that is "most profitable" is not supported by a single word in the entire record. Nowhere is there a word, not a word, which even indirectly points to a purpose to sell in order to make a profit. The Court of Appeals failed to point to such a word. Its extended and tortuous reasoning over this very simple problem of fact is but further indication of its failure to discover anything in the record actually showing such a fact's existence.

It is clear then that the said finding was not one drawn from the evidence, but one induced by a view of the law. It does not belong in the facts at all. *United*

States v. U.S. Gypsum Co., 333 U.S. 364, 394, 68 S. Ct. 525, 541. Indeed, it is *a non sequitur* so gross that an issue of due process could properly be raised in respect to it. *Tot v. United States*, 319 U.S. 463, 467, 63 S. Ct. 1241, 1245.

The said finding was one without which each of the courts below, on its own opinion, would obviously have decided the other way. The decision below is reversible, on that ground alone.

2.

In the Context Here the Term "Primarily" Means "of First Importance or Principally;" and Property Is Not "Held Primarily for Sale" Where the Only Thought of Sale Is the Idea of the Taxpayer, at the Time of Acquisition, That He Possibly May Have to Sell the Property if, at Some Indefinite Time in the Future, It Proves Ultimately Incapable of Development for Rental.

The word "primarily" first appeared in connection with capital gains in the Revenue Act of 1924.[4] It

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[4]The separate classification of "capital assets" under the federal income tax began with the Revenue Act of 1921. This court had held gain realized on the sale or conversion of capital assets to be income and therefore subject to a tax on income. *Doyle v. Mitchell Bros. Co.* 247 U.S. 179, 185, 38 S. Ct. 467, 469; *Eisner v. Macomber*, 252 U.S. 189, 207 40 S. Ct. 189, 193. Viewing the graduated rate schedule of the federal income tax as an impediment to sales and exchanges of such assets Congress, in the Revenue Act of 1921, gave them a favored status. 61 Cong. Rec. 6575-6. Under Section 206(b) of that act the tax on gains derived from the sale or exchange of capital assets was limited to 12½%, and under section 206(a)(6) thereof the term "capital assets" was defined to mean "property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business)" except "property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other

effected an extension of the term "inventory" to property not included in inventory under good accounting practice, such as real estate, O.D. 848, 4 CB 47 (1921), but held for the same purpose. This was thus an extension of the inventory concept to such property for the purpose of the exclusion from capital-asset classification.

This court has held that in the interpretation of statutes a court's "problem is to construe what Congress has written," that "Congress expresses its purpose by words," and that it is for the court "to ascertain—neither to add nor to subtract, neither to delete nor to distort." *62 Cases, etc. v. United States,* 340 U.S. 593, 596, 71 S. Ct. 515, 518. More directly this court stated, when it came to determine the meaning of the word "property" as used in an income tax statute:

> "In the first place, the words of statutes—including revenue acts—should be interpreted where pos-

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property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year."

In order to remove from capital-asset classification, property which under good accounting practice would not be included in inventory, but which nevertheless was not truly capital-asset, there was added to the exclusions from such classification, under section 208(a) of the Revenue Act of 1924, "property held by the taxpayer primarily for sale in the course of his trade or business." 68th Cong., 1st Session, House Report No. 179, p. 19, Senate Report No. 398, p. 22.

This added exclusion went too far, Congress concluded when it came to writing the Revenue Act of 1934. The reason was that it operated to deny capital-asset classification to property held by the taxpayer for resale otherwise than to customers of his, as securities held by the taxpayer for trading through brokers on his own account. To correct this the exclusion was limited by insertion of the words "to customers" and "ordinary," so that it now reads as follows: "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." 73rd Cong., 2d Session, House Report No. 1385, p. 22.

sible in their ordinary, everyday senses. The only relevant definitions of 'property' to be found in the principal standard dictionaries are the two favored by the Commissioner."

Crane v. Commissioner of Internal Revenue, 331 U.S. 1, 6, 67 S. Ct. 1047, 1051; followed in *Hanover Bank v. Commissioner,* 369 U.S. 672, 687, 82 S. Ct. 1080, 1089. Nor has this court ever held, for the purpose of either a narrow or a broad construction, that a term in a statute could be given a sense not provided by either the statute itself or known and relevant usage.

Examining the various dictionaries[5] here, three points are clear: (1) that the adverb "primarily" has a narrower scope than the adjective "primary," the adverb picking up, in fact, only the more common meanings of the adjective; (2) that both the adverb and the adjective may have a meaning in one context which they do not have in another; and (3) that if a thing is secondary it is not primary.

It is significant also that in not a single dictionary is the word "primarily" defined as "substantially," or the word "primary" as "substantial." This court has, it is true, in another context gone by mesne process from "primarily" to "substantial." This was *Board of Governors v. Agnew,* 329 U.S. 441, 67 S. Ct. 411. The statute involved there was the provision of the Banking

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[5]Webster's Third New International, Webster's New World (College Edition), Oxford English, Oxford Universal, Funk & Wagnall's, Brittanica World Language Edition of Funk & Wagnall's Standard, American Encyclopaedic, Standard, Century, New Century, Universal, Johnson's, Chamber's Twentieth Century, Virtue's English (Encyclopaedic Edition), The New Elizabethan Reference, Swan's Anglo American, A New English (on Historical Principles), The American College, Evans (A Dictionary of Contemporary American Usage), Bouvier's Law, Black's Law.

Act prohibiting, *inter alia*, any partner or employee of a partnership "primarily" engaged in underwriting from serving also in banks; and the case presented the question whether the entity involved there was "primarily engaged" in the underwriting business, although that business represented, quantitatively, less than 50 per cent of its total gross income. Going from the word "primary," by way of dictionaries, to "essential" and "fundamental," this court then reasoned that in the particular context the latter words must include "substantial" because otherwise the firm was not primarily engaged in any business, because firms which do underwriting normally engaged in other activities, and because the very same act, in a separate provision, specially limited firms which were "engaged principally" in the underwriting business. This led this court there to conclude: "If the underwriting business of a firm is substantial, the firm is engaged in the underwriting business in a primary way though by any quantitative test underwriting may not be its chief or principal activity." 329 U.S. at p. 446, 67 S. Ct. at p. 414.

In the case here, however, the context is wholly different; the question is, as to each of two specific pieces of property, the purpose for which that piece of property was primarily held, and this regardless of the purpose for which other pieces of property were held, or the business in which the taxpayer was primarily engaged. Senate Report No. 781, 82d Cong., 1951-2 C.B. 458, 482, ¶ 4; Rev. Rul. 57-565, 1957-2 C.B. 546. As to each sale the relevant purpose would be the one for which it was held during the period immediately preceding the sale. 3B Mertens §22.138, at fn. 89. Obviously a sale can result, as clearly the sales involved

here did, from factors other than a purpose of holding for sale, particularly holding for sale to customers in the ordinary course of trade or business. There is just no way of applying here the sentence quoted above from *Agnew.*

Also, there was not here, as in *Rollingwood Corp. v. Commissioner* (C.A. 9), 190 F. 2d 263, 264, a course of sales of the properties involved which by contract, statute, operating necessity, or otherwise was indissolubly part of and tributary to the day-to-day income-producing activities of the taxpayer, so that a trial court could not separate it or separately weigh it. Because of that situation in *Rollingwood,* in which the lease contracts, pursuant to statutory requirement, contained an option to the lessee to purchase, we have no need to consider that case here. It was, in fact, but a variant of the situation of sales of corn futures held for inventory support, involved in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46, 76 S. Ct. 20.[6] For that reason the court in *Rollingwood* had no need to define "primarily" as "substantially."

We submit that in the context here the term "primarily" means, as it did in *Municipal Bond Corporation v. Commissioner* (C.A. 8), 341 F. 2d 683, 687, and as the dictionaries show to be its common, chief, non-temporal sense, "of first importance or principally";

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[6]We take no issue with the holding in the *Corn Products* case, 350 U.S. at p. 52, that the exclusions from capital-asset classification are to be interpreted broadly, that is, in favor of the revenue. We have no such problem here.

and that sale to customers in the ordinary course of trade or business was clearly not such a purpose here. On the contrary, there was here, during the period preceding the sale, no purpose of sale at all, let alone as the primary purpose, let alone to customers, and let alone in the ordinary course of trade or business.

3.

Finally, the Court of Appeals Erred in Assuming That the Actual Sales Involved Here Made Sale the Primary Purpose of the Holding.

What the Court of Appeals said was that [R. 35] "when taxpayer resolved to sell, that purpose . . . became the primary purpose and the property was primarily held for the purpose of sale." The necessary assumption would be that previously it was not the primary purpose. But the resolve to sell here, except as a step in the course of entering into the actual sales involved, had no existence at all. Clearly then the said statement of the Court of Appeals begs the question whether at the time of the sales the purpose of sale was the primary purpose of holding.

The actual sales here, moreover, were neither to customers nor in the ordinary course of trade or business. Neither court below said that they were; it is clear that neither could say so. Obviously then those sales could not be proof of a purpose, whether or not primarily, to hold for sale to customers in the ordinary course of trade or business.

Thus by no feat of logic or illogic can the actual sales involved here, or the resolve to make them, be evidence of a purpose, required for denial of capital-gain treatment, to hold primarily for sale to customers in the ordinary course of trade or business. In this also the Court of Appeals clearly erred.

Conclusion.

We submit in conclusion that the courts below clearly erred, that the property sold could not be classified as other than "capital assets," and that the judgment entered should therefore be reversed.

GEORGE T. ALTMAN,
Attorney for Petitioners.

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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 487

WILLIAM MALAT AND ETHEL MALAT, PETITIONERS

v.

ROBERT A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The district court's memorandum opinion, findings of fact, and conclusions of law (R. 8–25) are not officially reported. The opinion of the court of appeals (R. 28–35) is reported at 347 F. 2d 23.

JURISDICTION

The judgment of the court of appeals was entered on May 27, 1965 (R. 35). The petition for a writ of certiorari was filed on August 23, 1965, and was granted on November 8, 1965 (R. 36; 382 U.S. 900). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether a taxpayer who holds property for either rental or sale to customers is entitled to capital gain treatment on the sale of such property in the normal course of business.

2. Whether there is adequate support in the record for the finding of the district court, which was affirmed by the court of appeals, that the property here in question was held for either rental or sale to customers in the ordinary course of business.

STATUTE INVOLVED

Internal Revenue Code of 1954:

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

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(26 U.S.C. 1221.)

STATEMENT

During the tax year here in question, 1956, and for a number of earlier years petitioner[1] was engaged

[1] Mrs. Malat is a party solely because she and her husband filed a joint income tax return for the year 1956. We refer to Mr. Malat as "petitioner."

full time in the real estate business, principally as a general partner in Louis Lesser Enterprises, Ltd. In the five years between its formation (R. 78) and the year here in issue, Lesser Enterprises had participated in a large number of real estate ventures, including the construction and rental of over 300 duplex apartment buildings and homes (R. 39, 74–77), the ownership and rental of an office building (R. 73), the organization of at least two shopping center projects (R. 39, 74–75), a number of ventures which subdivided large tracts of land, installed roads and utilities, and sold lots in the ordinary course of business (R. 40, 69–71, 72, 74, 22–23), and at least five separate sales of unimproved, bulk land for a gross sales price of more than $967,000.[2] On June 30, 1956

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[2] There was testimony concerning the following five sales of raw land:

	Sales price
Buena Park—100 acres (Ex. A, p. 6; R. 121–122)	$621,116.
Century Crenshaw Plaza Sale to Ponty—10.9 acres (Ex. A, p. 6; R. 4, 23–24)	222,800.
Century Crenshaw Plaza Sale to Hicks-Fenmore Development Co.—9 acres (Ex. A, p. 6; R. 4, 24)	123,781.
Lesser, Himmelstein, Bochet parcel (R. 73)	Price not stated.
Garden Canyon Development—40 to 60 acres (R. 73–74, 75–76, 78, 122–123)	Price not stated.
Total	967,697.

Lesser Enterprises' tax return indicates that it was also involved in at least three additional sales of land for a total price of $355,435. There was no testimony concerning two sales for

Lesser Enterprises had approximately $1,200,000 invested in land, joint ventures and partnerships (Ex. A, p. 4); during its 1956 tax year it received $171,000 in real estate commissions (Ex. A, p. 2; R. 77), had a net profit of approximately $275,000 from partnerships and ventures in the real estate business (Ex. A, p. 3; R. 69–77, 22–23), and reported a net profit of over $230,000 on sales of land (Ex. A, p. 6).

Petitioner was also a general partner in Lesser Industrial Properties which purchased land and constructed warehouses, factories, and similar industrial facilities for rental (R. 39). In addition to petitioner's real estate activities as a general partner in Lesser Enterprises and Lesser Industrial, he personally held interests in some real estate subdivisions and a shopping center (R. 40).

In 1954 petitioner, acting on behalf of Lesser Enterprises, formed a joint venture called Century Crenshaw Plaza, with the idea of acquiring a 45-acre parcel of land fronting on Century and Crenshaw Boulevards in Inglewood, California (R. 43, 64, 21). The joint venture was composed of five members, each with a 20 percent interest. In addition to Lesser Enterprises (which was represented by petitioner), the other venturers were Hicks, a real estate

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$248,000 and $64,670, respectively (Ex. A, pp. 5, 6). Petitioner testified that the third sale (for $42,765) was made to a partnership in which Lesser Enterprises had a continuing interest (R. 122; Ex. A, p. 6).

Exhibit A (unprinted) is the tax return for Louis Lesser Enterprises for the year ended June 30, 1956, which is contained in a supplemental record certified to this Court.

broker (R. 46, 108); Fenmore, a lawyer who was engaged primarily in the real estate business and was a licensed real estate broker (R. 112, 94, 96, 100–101, 108; Ex. 5, para. 14 (unprinted)); Millman, who had previously been in the dress business but was then actively looking for real estate deals (R. 46, 96, 100–101); and Rogen, who was involved in at least one other real estate venture with some of the same parties (R. 42, 63, 100–101).

On February 15, 1954 the joint venture acquired the 45 acre tract for $486,000 (R. 21–22).[3] There is some dispute about the purpose for which the venturers acquired the property. Petitioner testified that the property was in a "fast-growing area" and the venturers hoped to obtain sufficient financing at favorable terms to construct "a major apartment project" on it (R. 42, 118). However, he also testified that the mortgage market had been "rough", and they realized there was a substantial possibility that they might be unable to get "financing that would permit us to * * * get what we felt was a reasonable return on our equity investment," in which case they would sell the land if that was more profitable (R. 83–84, 118, 116, 100). One of the other venturers, Mr. Fenmore, testified that they "bought it [the land] * * * [because] there was a chance to make a very substantial profit on the sale or sales" (R. 100).

[3] The property had previously been in escrow for 6 months during which the seller and the venturers had it rezoned from agricultural to multiple residential dwellings. At the same time an adjacent piece of property which the seller retained was rezoned commercial. R. 21–22.

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The venturers first explored the possibility of obtaining financing to construct a large number of buildings containing approximately 1000 apartments (R. 46–49). However, the mortgage market continued to be "rough" and they were unable to get financing at terms that would have permitted them the profit they expected (R. 83–84, 118). The venturers then subdivided the inside 25 acres of the tract into 105 lots, put in streets and curbs, and installed water and sewage facilities (R. 22–23). All of these lots were sold at a profit within 9 months after the venturers had acquired the property (R. 9).[4] The venture reported the gains from the sales of these 105 lots as ordinary income on its information return and each of the venturers (including Lesser Enterprises and, through it, petitioner) reported these gains as ordinary income on their tax returns (R. 9, 23).[5] Meanwhile, the venturers explored, without success, the possibility of rezoning the two parcels fronting

[4] After the joint venture subdivided the inner portion into 105 lots and put in streets and utilities, it distributed that 25 acre portion of the tract to the five venturers who then formed a second joint venture, Century Crenshaw Properties, to which they transferred the subdivided 25 acres. Both joint ventures were owned by the same parties in the same proportions, except that Fenmore and Hicks each owned their interests in the second venture through corporations which they controlled. Thus the actual sales of the 105 lots were accomplished through the second joint venture (R. 22–23).

[5] A joint venture is taxed the same as a partnership. 1954 Code § 7701(a)(2). Both are required to file information returns, and the partners or joint venturers are taxed individually

on Century and Crenshaw Boulevards (totalling 20 acres) for commercial development (R. 51–52).

On October 15, and November 5, 1954 (eight and nine months, respectively, after acquisition of the tract) the joint venture sold the two frontage parcels. The nine acre piece fronting on Century Boulevard was sold for $123,781 to Hicks-Fenmore Development Co., which was a partnership comprised of Hicks, Fenmore and two corporations controlled by them. It eventually built a gasoline station on part of the property. The 11 acre parcel fronting on Crenshaw Boulevard was sold for $222,800 to George Ponty, a real estate developer, who built a number of apartment buildings on the property. (R. 23–24, 109, 93–94.)[6] While all parties concerned treated the subdivided 25 acre tract as having been held primarily for sale to customers in the ordinary course of busi-

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on their respective shares of the partnership's or joint venture's income. 1954 Code §§ 701, 702.

[6] There was some conflicting testimony as to whether a dispute among the venturers contributed to the decision to sell the two frontage parcels. Petitioner testified that "a lack of rapport amongst the partners" was one of the reasons for the two sales (R. 118). Another of the venturers, Mr. Fenmore, testified that there was no serious disagreement between the venturers until after the sales here in question (R. 99–101). In any event, the district court concluded on the basis of all the evidence that "[t]he rift between the partners may have expedited the sale but it appears that the failure to obtain rezoning and satisfactory financing was the primary cause of the sale which was the step intended by the parties to be taken at the time the property was acquired and while it was held, if the rezoning and financing failed" (R. 17, see also R. 25).

ness and reported the profits on sales of the 105 lots as ordinary income (R. 4, 23), the joint venture reported its approximately $127,000 gain from the sale of the remaining 20 acres as long-term capital gain on its information return.[7] The venturers, including Lesser Enterprises and, through it, petitioner, reported their shares of the profit as long-term capital gain (R. 4, 24). The Commissioner determined that the gain from the two sales should have been reported as ordinary income and asserted a deficiency against petitioner. He paid the deficiency and commenced the instant suit for a refund (R. 2–3).

The district court concluded that the "property was purchased and held for development *or sale* depending on which course appeared to be most profitable" (R. 17, emphasis in orginal; see also R. 22, 24–25, 125) and that the "[p]laintiffs have failed to establish by a preponderance of the evidence that the subject real properties were not held by Plaza primarily for sale to customers in the ordinary course of a trade or business" (R. 24). The district court accordingly held that petitioner "should have reported such gains as ordinary income" (R. 25).

The court of appeals affirmed, stating that "the record amply supports" the district court's finding that the property was acquired and held for sale or

[7] The joint venture originally paid $486,000 for the 45 acres. It allocated $266,765 to the subdivided 25 acres and $219,235 to the 20 acres of frontage land. The latter were sold for a total of $346,582, yielding a gain of $127,347. The subdivided land was also sold at a gain, but the record does not indicate the amount. R. 4, 23–24.

rental, whichever was more profitable (R. 34). The court noted that "in the case of one who deals generally in real estate the rational inference is that the purpose of the holding is all-encompassing," *i.e.*, that "the property was acquired and held with the purpose of realizing gain from it in any feasible manner which might present itself"; a real estate "dealer is, after all, in the business of acting in precisely that fashion" (R. 33, 34).

INTRODUCTION AND SUMMARY OF ARGUMENT

If a taxpayer is in the business of selling real estate, it is clear that his regular, recurring gains from sales of real estate will be taxed as ordinary income. Similarly, if the taxpayer is in the business of purchasing or constructing buildings which he rents out, his rental income constitutes ordinary income. (The same thing would, of course, be true if the taxpayer was in the business of either purchasing or manufacturing personal property which he then sold or which he then leased.) This case presents the question whether a taxpayer who is in the business of acquiring real estate (or personal property) which he holds for the dual purpose of either rental or sale, whichever is more profitable, can properly report his profits from sales in the normal course of business as capital gain.

The Internal Revenue Code defines capital gain as the profit resulting from the "sale or exchange" of "property" other than, *inter alia*, "property held by the taxpayer primarily for sale to customers in the

ordinary course of his trade or business." 1954 Code §§ 1221, 1222. Petitioner and other taxpayers who have acquired or manufactured assets for the dual purpose of either sale or rental in the regular course of their businesses have argued that they are entitled to capital gain because assets held for such a dual purpose are not held *"primarily"* for sale in the ordinary course of business. At best, they argue, their sale and rental motives were equal and thus neither was *primary;* in those cases where the taxpayers derive a majority of their revenue from rentals and only a minority from sales, they contend that the "primary" purpose for holding the asset was for rental rather than sale.

We shall show in Point I that "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss," *Corn Products Co.* v. *Commissioner,* 350 U.S. 46, 52, and meant only those gains that were "separate from the main-stream of the enterprise" to receive preferential capital gains treatment. *Recordak Corp.* v. *United States,* 325 F. 2d 460, 462 (Ct. Cl.). Manifestly, a taxpayer who is in the regular business of manufacturing or acquiring assets which he will either rent or sell depending on whichever outlet proves most advantageous should not be able to treat his normal business profits from sales as capital gains.

In a long line of decisions dealing with the capital gain provision this Court has held that the "exclusions [from capital gain treatment must be] inter-

preted broadly" when necessary "to effectuate the basic congressional purpose," *Corn Products Co.* v. *Commissioner,* 350 U.S. at 52, and that where necessary to prevent tax avoidance the language of the capital gain statute will be read in other than its "ordinary sense." *Commissioner* v. *Gillette Motor Co.,* 364 U.S. 130, 134. Moreover, the Court has in other contexts held that, where it is "more consonant with the legislative purpose" of a statute, the word "primarily" can be read as meaning "essentially" or "substantial." *Board of Governors* v. *Agnew,* 329 U.S. 441, 446, 447. Therefore, we believe, as do the majority of the courts which have ruled on the question, that a taxpayer in the business of manufacturing or purchasing property for either rental or sale in the normal course of business—so that sale in the ordinary course of business is one of his "essential" or "substantial" purposes for holding the asset—must pay an ordinary income tax on his gains from such regular business sales.

In Point II we shall show that the district court necessarily found, first, that the joint venture held the property here in question for the purpose of exploiting it in any manner which proved most profitable, including rental or sale in the ordinary course of business, and, thus, that an essential or substantial purpose for holding the property was for sale to customers in the ordinary course of business. Petitioner spends the major portion of his brief attempting to reargue the district court's factual findings, which were affirmed by the court of appeals. This

Court will not ordinarily review the concurrent findings of two lower courts. However, in any event, these essentially factual findings are, as the court of appeals held, "amply support[ed]" by the record.

ARGUMENT

I

A TAXPAYER WHO PURCHASES AN ASSET FOR EITHER RENTAL OR SALE IN THE ORDINARY COURSE OF HIS BUSINESS, WHICHEVER IS MORE PROFITABLE, IS NOT ENTITLED TO HAVE HIS REGULAR BUSINESS PROFITS FROM ITS SALE TAXED AS CAPITAL GAINS

In general, the Internal Revenue Code imposes an ordinary income tax on the profits derived from carrying on a trade or business.[8] This is true regardless of whether the regular business income is in the form of compensation for services, rental income, or proceeds from the sale of property. However, the Code generally gives preferential tax treatment to gains derived from sales of property outside the scope of normal business operations, on the theory that they usually result from a long-term passive investment.

If a taxpayer regularly purchases an item for resale, it is clear that his business profits derived from sales

[8] It is sometimes difficult to determine whether the particular activities from which the taxpayer derives his profit constitute a part of his trade or business, or are merely incidental profit-making activities. If the former, profits are taxable as ordinary income; if the latter, as capital gain. As we point out below (see *infra*, p. 29), if the taxpayer's "business" is defined unduly narrowly or technically—for example, if a realtor's business were viewed as the selling of a particular type of property rather than the real estate business generally—the inevitable effect would be to allow capital gains treatment on profits that actually are generated by the taxpayer's business activities.

of such items will be taxed as ordinary income. On the other hand, if the taxpayer were not in the business of selling such an item, his profit on the transaction would generally be taxed as capital gain. For example, a taxpayer who purchases a painting or a parcel of real estate and sells it at a profit after the requisite holding period is generally taxed at capital gain rates. If, however, the taxpayer in question was in the business of dealing in such property, his gain would be taxed as ordinary income. "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss," and that only those transactions "which are not the normal source of business income" would be taxed as capital gain. *Corn Products Co.* v. *Commissioner,* 350 U.S. at 52.[9]

However, in recent years there have been an increasing number of cases involving taxpayers in the dual business of either renting or selling a product, depending on the demand at the moment. These taxpayers have contended that although their profits on sales of such products are a normal and regular source of income, they must nevertheless be taxed at the preferential capital gain rate because the product was not "held * * * *primarily* for sale to customers in the ordinary course of his trade or business." 1954 Code

[9] The courts have enunciated a number of factors which bear on the question whether a taxpayer is engaged in a particular business, but in essence the application of this broad standard to a particular set of facts has been left to the trier of fact, subject to the "clearly erroneous" test. See *infra*, p. 23.

§ 1221 (1) [emphasis added].[10] According to this argument, "primarily" has reference to the taxpayer's chief or principal motive in holding the property in question, and if more than half of the taxpayer's revenues are from rental, his "chief" motive for holding the product is the production of rental income.

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[10] Congress first enacted a preferential rate for capital gains in 1921 in order to give "profits earned over a series of years" some relief from the graduated tax rates on ordinary income. H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10–11 (1939–1 Cum. Bull. (Part 2) at 176); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12–13 (1939–1 Cum. Bull. (Part 2) at 189–190). The original statute excluded from capital gain treatment "stock in trade" and "inventory." Revenue Act of 1921, c. 136, 42 Stat. 227, § 206(a)(6). In 1924 in order "to remove any doubt as to whether property [such as real estate] which is held primarily for resale constitutes a capital asset, whether or not it is the type of property which under good accounting practice would be included in the inventory" (H. Rep. No. 179, 68th Cong., 1st Sess., p. 19 (1939–1 Cum. Bull. (Part 2) at 255); S. Rep. No. 398, 68th Cong., 1st Sess., p. 22 (1939–1 Cum. Bull. (Part 2) at 281), Congress added an exception for "property held by the taxpayer primarily for sale in the course of his trade or business." Revenue Act of 1924, c. 234, 43 Stat. 253, § 208 (a)(8). During the depression a number of taxpayers who traded actively in the stock market on their own accounts were deducting stock market losses against ordinary income. Congress felt that such deductions should be subjected to the limitations on capital losses. Therefore, in order to make "it impossible to contend that a stock speculator trading on his own account" is in the trade or business of selling stocks (H. Conf. Rep. No. 1385, 73d Cong., 2d Sess., p. 22 (Amendment No. 66) (1939–1 Cum. Bull. (Part 2) at 632), Congress in 1934 amended the statutory exception to read "property held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business." Revenue Act of 1934, c. 277, 48 Stat. 680, § 117(b) (words in italics added in 1934). See also authorities cited *infra*, p. 31, fn. 25.

The same principles are, of course, applicable whether the case involves real estate or personal property. A taxpayer regularly in the business of holding land either for rental or for sale may acquire a particular parcel with the intention of exploiting it by whichever means proves most profitable. If he normally derives the majority of his income from rentals or if he testifies that his preponderant motive was to rent rather than resell the parcel in question, he may claim that his profit from an immediate resale in the ordinary course of business constitutes capital gain. See, *e.g.*, *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 (C.A. 9) (taxpayer built 700 houses on a tract of land and offered them for rent with an option to purchase; within four years it had sold all of the houses); *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992 (taxpayer constructed eight large commercial and industrial buildings according to the specifications of its tenants; most of them were leased with an option to purchase, and at least five of the options were exercised).

In all of these cases the taxpayers derived their regular business profits from two sources—rentals and sales. Regardless of which source gave rise to more revenue, it is clear that neither type of income should be capital gain. "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 [now 1954 Code § 1221] applies to

transactions in property which are not the normal source of business income." *Corn Products Co.* v. *Commissioner,* 350 U.S. 46, 52.

This Court has made it clear that a taxpayer cannot channel ordinary business profits into capital gain. If "necessary to effectuate the basic congressional purpose," "the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly." In no event may "the capital-asset provision * * * be so broadly applied as to defeat rather than further the purpose of Congress." *Corn Products Co.* v. *Commissioner,* 350 U.S. at 52. The Court has frequently read the words of the capital gain statute in other than their "ordinary sense" when necessary to carry out "the purpose of Congress" in enacting the capital gain section. *Commissioner* v. *Gillette Motor Co.,* 364 U.S. 130, 134. Whenever possible the Court has read the statutory exceptions to capital gain broadly, so as to exclude "profits * * * arising from the everyday operation of a business"; even when this was not possible the Court has denied capital gain to such profits by narrowly reading the definition of a capital asset. See *Corn Products Co.* v. *Commissioner,* 350 U.S. 46; *Commissioner* v. *Gillette Motor Co.,* 364 U.S. 130; *Commissioner* v. *P. G. Lake, Inc.,* 356 U.S. 260; *Burnet* v. *Harmel,* 287 U.S. 103; *Hort* v. *Commissioner,* 313 U.S. 28; *Kieselbach* v. *Commissioner,* 317 U.S. 399; *Watson* v. *Commissioner,* 345 U.S. 544; *United States* v. *Midland-Ross Corporation,* 381 U.S. 54.

There are, accordingly, two ways in which the Court could reach the result here advocated by the Commis-

sioner—either by narrowly reading the definition of a capital asset [11] or by broadly reading the exception for property held "primarily" for sale to customers in the ordinary course of business. Since the above statutory exception can easily be read to cover assets held for rental or sale in the normal course of business, we believe that the Court need not adopt the former alternative in this case.

Petitioner argues that the word "primarily" must be read as meaning "of first importance" or "chief." However, this Court has held that when necessary to implement the clear legislative purpose of a statute, the word "primarily" can be read as meaning "essentially" or "fundamentally" and that an "activity or function may be 'primary' in that sense if it is substantial." In *Board of Governors* v. *Agnew*, 329 U.S. 441, this Court examined a provision of the Banking Act of 1933 which prohibited any member of a partnership "primarily engaged" in the underwriting business from serving as an officer, director or employee of a federal bank. The respondents were directors of a federal bank and also partners of a brokerage firm deriving approximately 30 percent of its revenues from underwriting. The court of appeals had held that in order for a firm to be "primarily

[11] See, *e.g.*, *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, where the Court held that corn futures—which are concededly capital assets in the hands of some taxpayers—are not capital assets when held by a taxpayer which used them as "an integral part of its business" (p. 50). Similarly, we submit that assets held for sale-or-rental as an integral part of a taxpayer's normal business operations cannot be classified as capital assets.

engaged" in underwriting, that must be its chief or principal business. This Court reversed, saying (p. 446):

> It is true that "primary" when applied to a single subject often means first, chief, or principal. But that is not always the case. For other accepted and common meanings of "primarily" are "essentially" (Oxford English Dictionary) or "fundamentally" (Webster's New International). An activity or function may be "primary" in that sense if it is substantial. If the underwriting business of a firm is substantial, the firm is engaged in the underwriting business in a primary way, though by any quantitative test underwriting may not be its chief or principal activity. On the facts in this record we would find it hard to say that underwriting was not one primary activity of the firm and brokerage another. * * *

Such a construction of the word primarily is, concluded the Court, "not only permissible but also more consonant with the legislative purpose than the construction which the Court of Appeals adopted." In light of the "evil at which the section was aimed," "the line between substantial and unsubstantial seems to us to be the one indicated by the words 'primarily engaged.'" *Id.* at 447.

Similarly, in the instant case, it would clearly be "more consonant with the legislative purpose" to interpret "primarily" as including any case where one of the *essential* or *substantial* reasons for holding the asset was for sale to customers in the ordinary course

of business.[12] "[T]he evil at which * * * [§ 1221(1)] was aimed" is clear. It was designed to differentiate between "the profits and losses arising from the everyday operation of a business" (*Corn Products Co.* v. *Commissioner*, 350 U.S. at 52), on the one hand, and gains and losses resulting from a passive "appreciation in value accrued over a substantial period of time," on the other. *Commissioner* v. *Gillette Motor Co.*, 364 U.S. at 134; see H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10–11 (1939–1 Cum. Bull. (Part 2) at 176; S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12–13 (1939–1 Cum. Bull. (Part 2) at 189–190). In this context "the line between substantial and unsubstantial seems to us to be the one indicated by the [statutory] words" (*Board of Governors* v. *Agnew*, 329 U.S. at 447) "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." 1954 Code § 1221(1). Congress certainly did not intend to convert a taxpayer's regular business profits into capital gains merely because he both rented and sold the same type of asset.

Such reasoning has led three courts of appeals and the Court of Claims (as well as the Tax Court) to agree with the Commissioner's position. *Rollingwood*

[12] See also, *e.g.*, *Griffiths* v. *Commissioner*, 308 U.S. 355, 358 ("Legislative words * * * derive vitality from the obvious purposes at which they are aimed * * * ."); *United States* v. *American Trucking Ass'ns*, 310 U.S. 534, 542 ("The function of the courts * * * is to construe the language so as to give effect to the intent of Congress."); *Farmers Irrigation Co.* v. *McComb*, 337 U.S. 755, 764 ("We have * * * consistently refused to pervert the process of interpretation by mechanically applying definitions in unintended contexts.").

Corp. v. *Commissioner,* 190 F. 2d 263 (C.A. 9); *Greene-Haldeman* v. *Commissioner,* 282 F. 2d 884 (C.A. 9); *American Can Co.* v. *Commissioner,* 317 F. 2d 604 (C.A. 2), certiorari denied, 375 U.S. 993; *S.E.C. Corp.* v. *United States,* 140 F. Supp. 717 (S.D.N.Y.), affirmed *per curiam,* 241 F. 2d 416 (C.A. 2), certiorari denied, 354 U.S. 909; *Meridian, Inc.* v. *Commissioner,* 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992; *Recordak Corp.* v. *United States,* 325 F. 2d 460 (Ct. Cl.); *Bauschard* v. *Commissioner,* 279 F. 2d 115 (C.A. 6); *Harrah* v. *Commissioner,* 30 T.C. 1236.[13] The Eighth and Fifth Circuits have reached a contrary conclusion. *Municipal Bond Corp.* v. *Commissioner,* 341 F. 2d 683 (C.A. 8), and *United States* v. *Bennett,* 186 F. 2d 407 (C.A. 5).[14]

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[13] See also American Law Institute, *Definitional Problems in Capital Gains Taxation,* Discussion Draft, pp. 323–326 (Oct. 20, 1960), concluding that the gain should be ordinary income in such circumstances.

[14] The *Bennett* case dealt with the issue in a rather unusual context, *i.e.*, in light of the conditions present in the cattle industry. Because of the special problems presented by breeding animals, Congress subsequently enacted a special statutory provision exempting all breeding animals from the test here in question. Compare 1954 Code § 1231(b)(3) with § 1231(b)(1)(B). See Treas. Reg. § 1.1231–2 (b), (c) Example 3.

The Eighth Circuit in *Municipal Bond* relied heavily on *Bennett,* on its own earlier decision in *Albright* v. *United States,* 173 F. 2d 339 (C.A. 8), and on the Sixth Circuit's decision in *Gotfredson* v. *United States,* 303 F. 2d 464. All of these cases dealt with the sale of breeding animals; in fact, *Gotfredson* turned on the special statutory provision enacted to exempt breeding animals from the test here in question. In other cases, not dealing with breeding animals, the Sixth Circuit has, both before and after its *Gotfredson* decision, consistently agreed with the position here advocated by the Commissioner. *Meridian, Inc.* v. *Commissioner, supra; Bauschard* v. *Commissioner, supra.*

The *Recordak* case involved a taxpayer which manufactured microfilming equipment for either rental or sale. The Court of Claims commented that if sales are a part of the "normal stream" of the taxpayer's "[b]usiness enterprise," they are to be taxed at ordinary rates; only "gains classed as separate from the main-stream of the enterprise will receive more lenient treatment." In no event will "sales which form an accepted part of the taxpayer's regular business" be taxed at capital gain rates. "Whatever the precise scope of [the word 'primarily'] * * * in other contexts, it does not exclude from ordinary income the proceeds of sales by one, like plaintiff, who conducts a dual enterprise involving both rentals and sales of the same type of goods. In that setting, 'primarily' invokes a contrast, not between selling and renting, but between selling in the ordinary course of business and selling outside of that normal course. Accordingly, if the entrepreneur holds out his wares either for sale or for rental, the taxation of his business gain from sales does not depend upon a comparison of sales to rentals in the particular year." *Recordak Corp.* v. *United States,* 325 F. 2d 460, 462, 463 (Ct. Cl.).

Similarly, the *S.E.C. Corp.* case involved a taxpayer which held food and beverage coolers for either sale or rental and disposed of them "through whichever outlet materialized first or proved most advantageous." In denying capital gain treatment the court stated that "To carve out of its business for special tax treatment gains actually realized as a normal feature of the taxpayer's current business would" cause the

capital gain provision to "become a source of windfalls" to a taxpayer in "a rent-or-sell business," "rather than a relief from hardship." *S.E.C. Corp.* v. *United States,* 140 F. Supp. 717, 719, 720 (S.D. N.Y.), affirmed *per curiam,* 241 F. 2d 416 (C.A. 2), certiorari denied, 354 U.S. 909.

Therefore, we believe that the gain from a sale of real estate made in the ordinary course of business is taxable as ordinary income, although such sale was only one of the substantial purposes for which the taxpayer held the asset.[15]

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[15] Even if a taxpayer's sole motivation for acquiring or manufacturing an asset is for the production of rental income, his gain on sale will be subjected to an ordinary tax if he thereafter enters into a new business and holds the assets for sale to customers in the ordinary course of that new business. Whether he is merely liquidating property held solely for the production of income or has entered into a new selling business depends mainly on the extent of his selling activities. See, *e.g.*, *American Can Co.* v. *Commissioner,* 317 F. 2d 604 (C.A. 2), certiorari denied, 375 U.S. 993; *Recordak Corp.* v. *United States,* 325 F. 2d 460 (Ct. Cl.); *Patterson* v. *Belcher,* 302 F. 2d 289, 297–298 (C.A. 5), certiorari denied, 371 U.S. 921. For example, if a large car rental agency acquires new cars solely because of the rental income they will produce, it is normally entitled to capital gain on their sale, but if the company opens a used car lot and sells the used rental automobiles at retail to the public, its gain or loss is taxed at ordinary income rates. See, *e.g.*, Rev. Rul. 54–229, 1954–1 Cum. Bull. 124; cf. *Greene-Haldeman* v. *Commission,* 282 F. 2d 884 (C.A. 9); *Harrah* v. *Commissioner,* 30 T.C. 1236, 1241.

II

THE LOWER COURTS CORRECTLY FOUND THAT ONE OF THE ESSENTIAL OR SUBSTANTIAL PURPOSES FOR HOLDING THE PROPERTY WAS FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS

Whether a taxpayer's activities in a particular area are sufficiently substantial to constitute a trade or business is essentially a factual issue. The courts have enunciated a series of factors bearing on this question, including the number, continuity and frequency of the taxpayer's transactions, the amount of activity engaged in by the taxpayer or those acting under his instructions or in his behalf, and the extent or substantiality of the taxpayer's transactions. Once the trier of fact, using a correct legal standard, has found that the taxpayer was engaged in a trade or business and that the property in question was held for sale in the ordinary course of that trade or business, the appellate courts have generally reversed only if these findings were clearly erroneous.[16]

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[16] See, *e.g.*, *Ackerman* v. *United States*, 335 F. 2d 521 (C.A. 5); *Broughton* v. *Commissioner*, 333 F. 2d 492 (C.A. 6); *Stockton Harbor Industrial Co.* v. *Commissioner*, 216 F. 2d 638, 650, 655–656 (C.A. 9) certiorari denied, 349 U.S. 904; *Yara Engineering Corp.* v. *Commissioner*, 344 F. 2d 113 (C.A. 3); *Pennroad Corp.* v. *Commissioner*, 261 F. 2d 325, 330 (C.A. 3), certiorari denied *sub nom. Madison Fund, Inc.* v. *Commissioner*, 359 U.S. 958; *Coffey* v. *United States*, 333 F. 2d 945 (C.A. 10); *Mauldin* v. *Commissioner*, 195 F. 2d 714, 716–717 (C.A. 10); *Brady* v. *Commissioner*, 25 T.C. 682, 690; Mertens, *Law of Federal Income Taxation*, Vol. 3B, pp. 76–77; Note, "*Dealing*" *in Real Estate*, 2 Tax L. Rev. 111, 115–120 (1946); American Law Institute, *Definitional Problems in Capital Gains Taxation*, Discussion Draft, pp. 311–331 (Oct. 20, 1960).

The district court in the instant case necessarily reached two factual conclusions; first, that the joint venture was in the business of selling real estate, and, second, that one of the essential or substantial reasons for acquiring and holding[17] the property here in question was for sale to customers in the ordinary course of that business.[18] The court of appeals affirmed both of these essentially factual determinations and "in the absence of very exceptional showing of error" this Court will treat as "final" the "concurrent findings of the two courts below." *Comstock* v. *Group of Investors,* 335 U.S. 211, 214; see also, *e.g., Corn Products Co.* v. *Commissioner,* 350 U.S. 46, 51.[19] However, since petitioner spends a substantial portion of his brief attacking these factual findings we will demonstrate that they are, as the court of appeals noted, "amply support[ed]" by the record (R. 34).

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[17] Although the district court framed its finding in terms of the taxpayer's reasons for acquiring and holding the property, the statutory test is solely the purpose for which the property was "held." The motive for its acquisition is important only insofar as it sheds light upon the purpose of the holding. See *supra*, p. 22, n. 15.

[18] Because petitioner had the burden of proof, the district court phrased its ultimate finding in the negative, *i.e.*, that "Plaintiffs have failed to establish by a preponderance of the evidence that the subject real properties were not held by Plaza primarily for sale to customers in the ordinary course of trade or business" (R. 24; see also R. 16–17).

[19] The *Corn Products* case involved precisely the same type of question as is presented here. The Tax Court and court of appeals had both found that the taxpayer's corn futures transactions were "an integral part of its manufacturing business" and that its profits were not entitled to capital gain treatment despite the inapplicability of a statutory exception. In affirming, this Court refused to review that "essentially factual" finding and examined only the legal question.

The venturers, at least three of whom were engaged in the real estate business (see *supra*, pp. 3–4, 4–5 and *infra*, pp. 27–28), purchased the 45 acre tract here in question because it was located in a "fast-growing area" (R. 42, 114–115) and they were able to make "a good buy on the property as far as price [was] concerned" (R. 116). While they hoped to arrange financing that would enable them to build apartment buildings or other suitable structures on the property, they knew before acquisition that the mortgage market was "rough" and that there was a substantial chance that no construction would be undertaken (R. 83–84, 118, 116). In fact, they never had any intention of building on the property unless they could obtain financing on terms that would make it more profitable to retain the land rather than to sell it (R. 118, 100, 116). From the outset the venturers realized that the low price at which they had acquired the property gave them "a chance to make a very substantial profit on the sale or sales," either by subdividing or selling in bulk or some combination thereof (R. 100, 116). Within two months after the acquisition they subdivided 25 acres, installed streets and utilities, and began selling lots. Within 9 months after the original acquisition they had sold all 105 lots. The fact that some (if not all) of the venturers were regularly in contact with real estate buyers and developers in the regular course of their businesses combined with the location of the property in a rapidly growing area undoubtedly made it

unnecessary for them to advertise for buyers.[20] Even before the last of the 105 subdivision lots were sold, the venturers received "feelers" from brokers and others interested in purchasing the two frontage parcels (R. 114, 9, 23–24). The best offers—totalling more than $345,000—were made by George Ponty and the Hicks-Fenmore Development Co. After discussing whether to accept these offers or seek additional buyers, they decided that these were too good to reject (R. 101, 100, 118, 116).

Moreover, the venturers had already admitted that the joint venture was in the real estate business when it subdivided the 25 acre interior portion of the property here in question. They reported the gain from the sale of the resulting 105 lots as ordinary business income. This would have been proper only if the venture was engaged in the business of selling real estate and was holding the land for sale to customers in the ordinary course of its trade or business, the very question involved in the instant case.[21]

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[20] See, *e.g.*, *Brady* v. *Commissioner*, 25 T.C. 682, 690; *Pennroad Corp.* v. *Commissioner*, 261 F. 2d 325, 330 (C.A. 3), certiorari denied *sub nom. Madison Fund, Inc.* v. *Commissioner*, 359 U.S. 958; *Stockton Harbor Industrial Co.* v. *Commissioner*, 216 F. 2d 638, 655–656 (C.A. 9), certiorari denied, 349 U.S. 904; *Coffey* v. *United States*, 333 F. 2d 945 (C.A. 10); *Mauldin* v. *Commissioner*, 195 F. 2d 714, 717 (C.A. 10); American Law Institute, *Definitional Problems in Capital Gains Taxation*, Discussion Draft, pp. 318–327 (Oct. 20, 1960).

[21] It is irrelevant that the joint venturers removed the subdivided 25 acres from the original joint venture after the utilities had been installed and had a second joint venture make the sales of the 105 lots. Whether the joint venture is in business depends on the substance of the activities rather

Finally, the evidence shows that the three most active members of the joint venture were engaged in the real estate business.[22] Lesser Enterprises (in which petitioner was an active general partner and through which petitioner derived his share of the gains here in question) was engaged in the full time business of exploiting real estate in any fashion which

---

than the formalities. A taxpayer or group of taxpayers cannot turn ordinary income into capital gain by formally dividing the ownership of his or their assets between two joint ventures. See, *e.g.*, *Broughton* v. *Commissioner*, 333 F. 2d 492, 495–496 (C.A. 6).

[22] If the joint venture which held the land was in the real estate business, all of the venturers' gains on the sales here in question would be taxable as ordinary income. 1954 Code § 702 (b). In making such a determination the fact that the active or managing venturers were engaged in very similar or even identical businesses would certainly be relevant. See, *e.g.*, *Broughton* v. *Commissioner*, 333 F. 2d 492, 495–496 (C.A. 6); *Ackerman* v. *United States*, 335 F. 2d 521 (C.A. 5); *Margolis* v. *Commissioner*, 337 F. 2d 1001, 1005–1007 (C.A. 9), rehearing denied, 339 F. 2d 537 (C.A. 9); *Rossiter* v. *United States*, 60–1 U.S.T.C. para. 9170 (N.D. Ill., Dec. 11, 1959); *Schultz* v. *Commissioner*, 44 B.T.A. 146, appeal dismissed, 123 F. 2d 1020 (C.A. 9); *Goodman* v. *Commissioner*, 40 B.T.A. 22. Cf. Treas. Reg. § 1.1375–1(d). However, even if under this test the joint venture had not been in the real estate business, Lesser Enterprises' (and thus petitioner's) share of the gain would nevertheless have been taxable as ordinary income. A taxpayer who is engaged full time in the real estate business cannot transform his profits into capital gain by actively engaging in business through a number of joint ventures. In such a case a taxpayer's real estate activities will be viewed as a unit and his share of the gains taxed accordingly. Cf. 1954 Code § 751(d)(2)(D) (certainly if—as this Code section requires—a partner's gain on the sale of his partnership interest will be taxed as ordinary income to the extent that it is attributable to assets held by the partnership that would be inventory in his hands, the same must be true if the assets were sold directly by the partnership); Treas. Reg. § 1.1375–1(d); 1954 Code § 341(e)(5).

proved to be most profitable at the moment. Shortly after the sale here in question Lesser Enterprises had approximately $1,200,000 invested in land, joint ventures and partnerships, and had in one year realized gains of approximately $645,000 in connection with real estate transactions.[23] Lesser Enterprises and petitioner were involved in the development of apartment buildings, homes, an office building, and shopping centers; they had also sold a substantial amount of land, both by subdividing and, where more profitable, in larger tracts. In the five years since Lesser Enterprises had been organized it had participated in at least five bulk sales of land for more than $950,000. The other two active venturers, Hicks and Fenmore, were also actively engaged in the real estate business (see *supra*, pp. 4–5).[24]

Based on this evidence the district court correctly concluded that petitioner had failed to sustain his

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[23] The breakdown is as follows:

Net profit on sales of land	$230,000
Net profit from partnerships and ventures in real estate	275,000
Net profit from real estate commissions (gross fees $171,000, less $31,000 expenses)	140,000
Total	645,000

See *supra*, pp. 3–4; Ex. A (unprinted).

[24] In this respect the situation is far different from that considered in Rev. Rul. 57–565, 1957–2 Cum. Bull. 546, where a taxpayer not otherwise in the real estate business was not regarded as holding a large piece of land for sale to customers merely because he had subdivided a part of the tract. The instant case is far closer to that discussed in Rev. Rul. 62–141, 1962–2 Cum. Bull. 182, and *Goldsmith* v. *Commissioner*, 143 F. 2d 466, 467 (C.A. 2) (opinion of Judge L. Hand), certiorari denied, 323 U.S. 774.

burden of proving that the property was not held for sale to customers in the ordinary course of business. Petitioner cannot escape the district court's findings by arguing that the joint venture's business must be narrowly viewed, *i.e.*, that the business included only sales of residential real estate. To fragment the venture's activities and label only some a business and the rest as outside the scope of the business would permit easy evasion of Congress' intent that all profits from normal business transactions be taxed as ordinary income.

Petitioner apparently contends, however, that even if one of the essential or substantial reasons for holding the property was for sale in the ordinary course of business, nevertheless, the sale to Hicks-Fenmore Development Co. was in essence a sale by three of the joint venturers to the other two joint venturers and thus was not a sale to customers in the ordinary course of business. There are at least two answers to this argument. First, petitioner and the other venturers sold the property to Hicks-Fenmore Development Co. only because it made a better offer than the other available buyers; in this sense Hicks-Fenmore Development Co. was no different than any other customer. See, *e.g.*, *Patterson* v. *Belcher*, 302 F. 2d 289, 290–294 (C.A. 5), certiorari denied, 371 U.S. 921 (holding that sales to a related corporation can constitute sales to customers in the ordinary course of business). The courts have long held that anyone engaged in the business of selling property sells it to customers whenever he finds someone who

will purchase it. In one frequently cited case the Board of Tax Appeals held that:

> Where, as here, one is regularly engaged in the business of buying and selling real estate, as was petitioner, any person who can be found to buy such property is a customer, as that term is ordinarily understood, and where such property is held for sale under such circumstances it must be deemed to be held for sale to customers within the meaning of the statute. [*Black v. Commissioner,* 45 B.T.A. 204, 210.]

As Judge Learned Hand stated the same principle, those "whose custom the taxpayer seeks * * * are his 'customers.'" *Goldsmith* v. *Commissioner,* 143 F. 2d 466, 468 (C.A. 2), certiorari denied, 323 U.S. 774. See also *Gamble* v. *Commission,* decided October 27, 1955 (P-H Memo T.C., para. 55,289, affirmed, 242 F. 2d 586 (C.A. 5) ("one engaged in the continuous purchase and sale of property, as this petitioner was, has dealings with a 'customer' whenever he sells."); *Pennroad Corp.* v. *Commissioner,* 261 F. 2d 325, 330 (C.A. 3), certiorari denied *sub nom. Madison Fund, Inc.* v. *Commissioner,* 359 U.S. 958; *Stockton Harbor Industrial Co.* v. *Commissioner,* 216 F. 2d 638 (C.A. 9), certiorari denied, 349 U.S. 904. Cf. *Watson* v. *Commissioner,* 345 U.S. 544.[25]

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[25] As pointed out *supra*, p. 14, fn. 10, the words "to customers" and "ordinary" were added to the statutory language in 1934 in order to prevent people who were actively trading in the stock market from contending that their activities were sufficient to constitute a trade or business and thus permitting them to deduct stock market loses suffered during the depression as ordinary rather than capital losses. Since stock market speculators sell a fungible item to buyers they never see,

Second, even if the transaction with Hicks-Fenmore Development Co. were not a sale to a customer in the ordinary sense, petitioner's gain would nevertheless be taxable as ordinary income. Section 1221(1) does not refer to the manner in which the property was sold, but to the purpose for which it was held. As this Court has recognized, if a taxpayer sells his entire business, he must report the gain on property held for sale to customers as ordinary income although it was sold in bulk rather than in the normal course of business. *Watson* v. *Commissioner*, 345 U.S. 544. See also *Williams* v. *McGowan*, 152 F. 2d 570 (C.A. 2); *Monaghan* v. *Commissioner*, 40 T.C. 680; Rev. Rul. 55–79, 1955–1 Cum. Bull. 370.[26]

Congress believed that requiring a sale to be not merely "in the course of business" but also "to customers" would exclude them. While the original purpose of the 1934 amendment was "to prevent tax avoidance" by "a stock speculator trading on his own account," S. Rep. No. 558, 73d Cong., 2d Sess., p. 12 (1939–1 Cum. Bull. (Part 2) at 595); H. Conf. Rep. No. 1385, 73d Cong., 2d Sess., p. 22 (Amendment No. 66) (1939–1 Cum. Bull. (Part 2) at 632), the amendment created a permanent exception to the general rule that if a taxpayer's activities are sufficient to constitute a business his normal gains will be taxed as ordinary income. (Thus today even an active securities trader is entitled to capital gain treatment.) Therefore, in the context of a taxpayer actively engaged in the real estate business, the words "to customers" add little to the statutory requirement that the sales be in the ordinary course of his business. *Kemon* v. *Commissioner*, 16 T.C. 1026, 1032; Mertens, *Law of Federal Income Taxation*, Vol. 3B, p. 79–80; Note, "*Dealing*" *in Real Estate*, 2 Tax L. Rev., 111, 114–115 (1946); American Law Institute, *Definitional Problems in Capital Gains Taxation*, Discussion Draft, pp. 330–331 (Oct. 20, 1960).

[26] Finally, petitioner contends that the sale to Hicks-Fen-

In summary, Congress intended "to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time." *Commissioner* v. *Gillette Motor Co.,* 364 U.S. at 134; see H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10–11 (1939–1 Cum. Bull. (Part 2) at 176); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12–13 (1939–1 Cum. Bull (Part 2) at 189–190). Petitioner's gains here in question are, on the other hand, typical profits generated by active participation in a business enterprise. Within 9 months after acquiring the land, the venturers (at least three of whom were actively engaged in the real estate business) installed roads and utilities, and sold 105 residential lots and two 10 acre parcels. The joint venture's conceded business activities in subdividing the 25 acres undoubtedly played a substantial part in causing the adjoining 20 acres here in question to rise so rapidly in value during the less than nine months the joint venture held it (R. 112, 114–115). Profits made in such a manner are the antithesis of passive, long term accretions in value and fall squarely in the category of "profits * * * arising from the everyday operation of a business" which Congress intended to tax "as ordinary income * * * rather than capital gain." *Corn Products Co.* v. *Commissioner,* 350 U.S. at 52.

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more Development Co. was really like a sale of his (*i.e.*, Lesser Enterprises') interest in the joint venture. Pet. Br. p. 10. Even if this were so, his gain on the sale would clearly be ordinary income if the property here in question had been held for sale to customers. 1954 Code § 751.

CONCLUSION

The judgment below is correct and should be affirmed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

October Term, 1965
No. 487

WILLIAM MALAT and ETHEL MALAT,

Petitioners,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue,

Respondent.

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

A. Examination of Respondent's Statement.

Respondent argues a case, but not this case. His statements as to the significant, critical facts misrepresent the record so vitally and so baldly that his arguments based upon them have no relevance whatever to to the questions presented here, even as respondent has tendentiously framed those questions. We show now the more serious of these misrepresentations.

1. On page 3 respondent points out that, during the five years prior to the year here in question, 1956, Lesser Enterprises had participated in, *inter alia,* "the construction and rental of over 300 duplex apartments and homes", but he fails to observe that at the time of trial, 1964 [R. 37], more than *eight years* later, Lesser Enterprises still owned them and still rented them [R. 75].

Also, at the same page respondent points out that Lesser Enterprises participated in "the organization of at least two shopping centers", but fails to state that they were holding their interests in the said shopping centers for income [R. 39].

Also, at the same point respondent refers to "at least five separate sales of unimproved, bulk land", giving details in a footnote, but fails to state that two of those sales were the very sales involved here.

2. On page 4 respondent refers to petitioner Malat's interest in Lesser Industrial Properties, "which purchased land and constructed warehouses, factories, and similar industrial facilities for rental", but fails to note that the buildings were held *only* for lease, and were being leased on a fairly long-term basis [R. 39].

3. On page 5 respondent says, in reference to the property involved here, "There is some dispute about the purpose for which the venturers acquired the property." In support of this he says petitioner testified "that the property was in a 'fast-growing area' and the venturers hoped to obtain sufficient financing at favorable terms to construct a 'major apartment project' on it," [citing R. 42, 118]. But, he says, petitioner also "testified that the mortgage market had been 'rough' and they realized there was a substantial possibility that they might be unable to get 'financing that would permit us to * * * get what we felt was a reasonable return on our equity investment,' in which case they would sell the land if that was more profitable" [citing R. 83-84, 118, 116, 100]. Basing on those two facts the idea of a dispute in the evidence is a not very subtle misrepresentation of the record.

(a) In the first place, as shown by R. 42, the statement that the venturers hoped to obtain sufficient financing at favorable terms to construct a major apartment project relates to a hope held by them before escrow was opened. Indeed, as shown by R. 46, exploration of the mortgage market in respect to the particular property was not begun until escrow was opened and the property tied up. But the page in the record which contains the wording subquoted above beginning with the word "financing" [R. 118], refers to a determination made by the venturers after such exploration, indeed, several months after close of escrow. It could hardly therefore contradict hopes of the venturers before they opened escrow, or show a dispute about the purpose "for which the venturers acquired the property".

(b) In the second place, the purpose "for which the venturers acquired the property", as brought out by the trial court, is nowhere controverted. We quote, R. 86:

> "The Court: All right. When you bought the property originally, the 49 acres, you had in mind developing the entire 49 acres under this FHA project which called for more than four units.
>
> "The Witness: Well, the entire project less any portion that we might have indicated to us could possibly be zoned commercially, because commercial has more value to us."

[See also R. 42]. Nowhere in the record is there anything in conflict with this.

(c) In the third place, respondent (although it was he who, after petitioners' opening brief had been filed,

had the exhibits in the case added to the record here, as to which petitioners made no objection) failed to quote from Exhibit 5, the venturers' agreement dated August 12, 1953, on which he otherwise relies (Br. 5), the following statement, on page 2, of the venturers' original purpose:

> "to own, hold, manage, improve, develop, and operate the real property to the benefit of the joint venture";

and the provision, on page 6, that the agreement "shall continue in full force and effect for a period of thirty (30) years from the date hereof."

(d) In the fourth place, and still more significantly, there is absolutely not a word to support the wording of respondent quoted above, from his page 5, "in which case they would sell the land *if that was more profitable.*" (Italics supplied). We mean there is not a word to support this not only in the pages there cited by respondent [R. 83-84, 118, 116, 100], but in the entire record.

(e) Finally, in his very next sentence, in an obviously desperate attempt to support the wording above italicized as to why the joint venture of which Lesser Enterprises was a member bought the property, respondent quotes from R. 100 a neatly carved out portion of the testimony of Fenmore as to why, as that page clearly shows, he and Hicks *bought it from* the joint venture.

In summary under this point 3, it can be seen that there is no dispute and no doubt as to the purpose for which the venturers acquired the property, and that the purpose was strictly investment. The possibility that

they might "sell the whole thing off in bulk" *so they wouldn't get hurt* [R. 22], if their investment plans could not be carried out, does not conflict with a purpose of investment as the primary purpose for which the property was held. On the contrary, we submit, it confirms that purpose. It was but the logical and normal course for saving the investment from loss.

4. On page 6 respondent says that the venturers explored the possibility of getting financing to construct buildings containing about 1000 apartments, but were unable to get "financing at terms that would have permitted them *the profit* they expected." (Italics supplied). But the pages cited by respondent show nothing whatever about a *profit* that was expected. What they show is that the venturers were unable to get "financing that would permit [us] to build apartments for rent and get what we felt was a reasonable return on our equity investment." This, moreover, was in relation to the frontage properties [R. 118], after the inner portion had been subdivided and sold. Respondent keeps on inserting the word "profit", everywhere, to suggest the idea of a holding for sale, despite the complete and total absence of any support for this anywhere in the record.

5. In a footnote on page 7 respondent says that Mr. Fenmore "testified that there was no serious disagreement between the venturers until *after the sales here in question.*" (Italics supplied). Respondent cites for this R. 99-101. But he fails to note, at R. 101-102, the testimony of the same witness, who was respondent's own witness, and which was based on a deposition of him taken by respondent. That testimony shows that when the said sales occurred the disagreement be-

tween the venturers already existed, that at that time the "personal relationship" of the venturers "was not a happy one." We quote from that testimony, p. 101:

> "A. Well, I think it goes much further than that. We were not happy with the other people, especially Lesser, and we made the partnership an offer of a substantial price for the land and said either the land should be sold to somebody else or sold to us.
>
> "I can only go back to say it was not a pleasant period in our relationship and that is the way it ended up."

That testimony is plainly consistent with the testimony of Mr. Malat [R. 79-80], that the partnership began to fall apart about four months before those sales, and his testimony brought out by the trial court, quoted in our opening brief, pp. 7-8, showing that the dispute was the sole reason for those sales. We emphasize this only because this effort of respondent to show that the venturers were in peace and harmony when these sales were made is part and parcel of his effort to support his fiction that there was a profit motive in the sales.

B. Examination of Factual References in Respondent's Argument.

The attempt of respondent to misrepresent the record before this court is continued and pressed in his argument. We show again the more serious of such misrepresentations.

1. Thus, in the title on page 12 of his brief, and again on page 25 of his brief, respondent repeats as to the facts his wholly false "more profitable" thesis re-

ferred to in point 3(d) above. Also on page 25, in an even more ill-adorned form, he restates the misrepresentation shown in point 3(e) above. Respondent there says that the price at which the venturers "had acquired the property gave them 'a chance to make a very substantial profit on the sale or sales', either by subdividing or selling in bulk or some combination thereof" [citing R. 100, 116]. The subquoted words, of course, as the cited pages show, relate only to the purchase by Fenmore and Hicks *from* the joint venture; they have no connection, not even the remotest, with the acquisition of the property in the beginning *by* the joint venture.

2. On the next page, 26, respondent embellishes the above misrepresentation by saying that the offers from Ponty and Hicks-Fenmore were the "best offers". But the record nowhere shows any other offers. In the next sentence respondent says the venturers went into discussion to determine "whether to accept these offers *or seek additional buyers*" (Italics supplied). But the record is completely wanting in anything to show consideration of seeking additional buyers, or seeking any buyers at all.

3. At the same point respondent seeks to draw an admission from the venturers' reporting of the gains on the inner portion as ordinary income. But the sales of the inner portion, as the Court of Appeals pointed out, R. 30, resulted from the need for funds to pay interest charges and other costs. Despite that, they reported those gains as ordinary income. This represents no admission as to the purpose, after selling the inner portion, for holding the frontage parcels, for as the

Court of Appeals there observed, "The frontage parcels were retained, still in hope that commercial zoning could be secured as to them." [R. 30]. Clearly, what the venturers saw was ordinary income on the inner portion because it had been subdivided. Whether they were right or wrong on that is not before this court; only the frontage parcels are here involved.

4. On page 29 respondent says that the venturers sold the property to Hicks-Fenmore "only because it made a better offer than the other available buyers." This is a repetition in slightly different words of the misrepresentation of the record with the words "best offers" referred to in point 2 above.

5. On page 32, as at least at a dozen prior points in his brief, respondent refers to the 9-month period of holding, being the nine months between the close of escrow and the sales involved. Nowhere does he note that the close of escrow was a full 6 months after opening, and that in the meantime, as the summary of the Court of Appeals shows [R. 29], because of their investigations "the intentions of the venturers with respect to the land had undergone a series of changes." Not that the position of petitioners is so much better because the actual period involved was 15 months instead of 9, but that this is just part of respondent's studied and unremitting effort to distort and make over into his own image the record before this court.

6. Finally, on the same page, page 32, respondent attempts to attribute the gains on the frontages to an increase in value resulting from the subdivision of the inner portion. But there is no evidence whatever in support of this. The very pages cited by respondent show

[R. 42] that it was a "fast-growing area", [R. 114-115] that these increases could result from any subdivision in the area, and that subdivision in the area could instead depress the value, depending on the total situation. And we ask this court to take judicial notice of the rapid growth during the past decade and more in the entire Los Angeles area. Fifteen months is a long time from that standpoint in Los Angeles.

C. Reply to Respondent's Argument.

Respondent makes no effort to answer petitioners' contentions; throughout his argument he sets up other contentions as straw men which he attacks. We shall of necessity deal with them accordingly.

I.

Respondent's first proposition (Br. 12), is that a person who purchased an asset "for either rental or sale in the ordinary course of his business, whichever is more profitable," is not entitled to have "his regular business profits from its sale taxed as capital gains." But this is not our case.

He begins under that proposition with the assumption, (Br. 13), that a person in the real estate business cannot possibly hold a piece of real estate as an investment. But the very facts here brought out by respondent himself, amplified above, show that their major properties were held as investment. That a person who holds real estate for sale to customers in the ordinary course of trade or business can also hold real estate as investment, even a part of the same parcel, is beyond question. Respondent has himself so ruled (Rev. Rul. 57-565, 1957-2 C.B. 546, cited in petitioners' opening brief,

p. 15). Real estate is a common subject of investment. It is the same as with a person in the securities business.

Respondent's authorities on this point have no pertinence at all. They include (Br. 15-21), houses constructed for lease with option to purchase; coolers, microfilming equipment, automobiles, et cetera, held for rent or sale; corn futures held for inventory support; and consideration received for temporary seizure of property, income from oil and gas leases, consideration for cancellation of a lease, the excess received for delay in connection with an award for property, consideration for an unmatured crop, and the excess received over issue price on non-interest bearing promissory notes. The sales involved here have no sensible connection with any of those situations.

We do not contend that a person who holds property for rent or sale in the course of his day-to-day business operations, as in the very common case of persons in the business of leasing equipment with option to buy, can claim capital gain on the sales. The same situation in connection with real estate is entitled to no different treatment. In every such rent-or-sell case there is a course of sales which is an inseverable part of the taxpayer's day-to-day business operations. Indeed, the rental in such cases is hardly more than an initial stage or variant of a sale. We covered this point clearly in our opening brief, at page 16.

But this has nothing whatever to do with the situation here. In this connection we quote from a deposition taken by respondent and *read into the record by respondent,* at [R. 118]:

> "Incidentally, even at that time [when the offers for the two frontage pieces involved here were received], we were not offering those properties for sale; the Crenshaw or the Century properties. They were not listed with brokers. They were not advertised for sale. They were not being offered for sale."

It is impossible, as of any point of time, no matter how imaginatively the record is read, to give a rent-or-sell cast to those two pieces of property, as they were, or as they were planned to be improved. We say here again, as in reference to respondent's other carefully designed distortions of the record, he is arguing a case, but not this case.

II.

As his second proposition respondent contends that the lower courts found "that one of the essential or substantial purposes for holding the property was for sale to customers in the ordinary course of business;" but even if there were such a finding, which there was not, it is not sufficient.

We submit again that a finding "that one of the essential or substantial purposes for holding the property was for sale to customers in the ordinary course of trade or business", is insufficient for denial of the gain

as capital gain. No such finding was in fact made, by either court below; but we assume for the purpose here that it was.

The statute requires that the property be held *primarily* for sale to customers in the ordinary course of trade or business. The word "primarily" is not a word of art; it is a word of common, everyday use. So is "substantial," and very clearly they do not mean the same thing. Nor is there anything in the statute here from which it can be concluded that Congress, by the word "primarily", meant anything but "primarily".

Perhaps respondent's effort here, however, is spelled out in his statement at page 19 of his brief, where he states: "Congress certainly did not intend to convert a taxpayer's regular business profits into capital gain merely because he both rented and sold the same *type* of asset." (Italics supplied). What respondent is saying there is that if a person holds any real estate for sale to customers in the ordinary course of his trade or business, then he cannot get a capital gain on *other* real estate even though it is held for rental only, without any intention to sell. Even the rent-or-sell doctrine does not go that far. Certainly there is nothing anywhere in any statutory provision to support this.

In a footnote (Br. 27), respondent tries still another idea. He cites there 1954 Code §702(b), which says that the character of an item on a partner's return is to be determined as if it had been realized directly from the source from which realized by the partnership. But respondent cites it for the proposition that: "If the joint venture which held the land was in the real estate business, all of the venturers' gains on the sales here in

question would be taxable as ordinary income." This is a wholly different proposition. There is nothing in the cited statutory provision, nothing whatever, which by any possibility can be interpreted as saying that.

By way of summary, it is obvious that what respondent is really trying to do is to reach the subconscious of this court. Respondent repeats and repeats suggestive phrases. For example, there are forty-two places in the brief where respondent uses the phrase "ordinary course of trade or business," or equivalent phrases such as "normal course of business" and "everyday operation of business." There is also obvious an attempt to confuse the court, to entangle it by constant repetition of irrelevancies, and to prejudice the court by constant repetition of phrases having no connection with the facts, and tying together as if spoken in one breath, different portions of the testimony relating to different periods and different subjects. It is not the mind of the court to which respondent's brief is directed but to its subconscious.

Conclusion.

We submit in conclusion that the courts below have clearly erred and should be reversed.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

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SUPREME COURT OF THE UNITED STATES

No. 487.—October Term, 1965.

William Malat et ux., Petitioners, *v.* Robert A. Riddell, District Director of Internal Revenue.	On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[March 21, 1966.]

Per Curiam.

Petitioner was a participant in a joint venture which acquired a 45-acre parcel of land, the intended use for which is somewhat in dispute. Petitioner contends that the venturers' intention was to develop and operate an apartment project on the land; the Commissioner's position is that there was a "dual purpose" of developing the property for rental purposes or selling, whichever proved to be the more profitable. In any event, difficulties in obtaining the necessary financing were encountered, and the interior lots of the tract were subdivided and sold. The profit from those sales was reported and taxed as ordinary income.

The joint venturers continued to explore the possibility of commercially developing the remaining exterior parcels. Additional frustrations in the form of zoning restrictions were encountered. These difficulties persuaded petitioner and another of the joint venturers of the desirability of terminating the venture; accordingly, they sold out their interests in the remaining property. Petitioner contends that he is entitled to treat the profits from this last sale as capital gains; the Commissioner takes the position that this was "property held by the taxpayer

primarily for sale to customers in the ordinary course of his trade or business," [1] and thus subject to taxation as ordinary income.

The District Court made the following finding:

> "The members of [the joint venture], as of the date the 44.901 acres were acquired, intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable. The venturers realized that they had made a good purchase price-wise and, if they were unable to obtain acceptable construction financing or rezoning . . . which would be prerequisite to commercial development, they would sell the property in bulk so they wouldn't get hurt. The purpose of either selling or developing the property continued during the period in which [the joint venture] held the property."

The District Court ruled that petitioner had failed to establish that the property was not held *primarily* for sale to customers in the ordinary course of business, and thus rejected petitioner's claim to capital gain treatment for the profits derived from the property's resale. The Court of Appeals affirmed, 347 F. 2d 23. We granted certiorari (382 U. S. 900) to resolve a conflict among the Courts of Appeals [2] with regard to the meaning of the

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[1] Internal Revenue Code of 1954, § 1221 (1), 26 U. S. C. § 1221 (1):

"For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

"(1) . . . property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

[2] Compare *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263, 266 (C. A. 9th Cir.); *American Can Co.* v. *Commissioner*, 317 F. 2d 604, 605 (C. A. 2d Cir.), with *United States* v. *Bennett*, 186 F. 2d 407, 410–411 (C. A. 5th Cir.); *Municipal Bond Corp.* v. *Commis-*

term "primarily" as it is used in § 1221 (1) of the Internal Revenue Code of 1954.

The statute denies capital gain treatment to profits reaped from the sale of "property held by the taxpayer *primarily* for the sale to customers in the ordinary course of his trade or business." (Emphasis added.) The Commissioner urges upon us a construction of "primarily" as meaning that a purpose may be "primary" if it is a "substantial" one.

As we have often said, "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." *Crane* v. *Commissioner*, 331 U. S. 1, 6. And see *Hanover Bank* v. *Commissioner*, 369 U. S. 672, 687–688; *Commissioner* v. *Korell*, 339 U. S. 619, 627–628. Departure from a literal reading of statutory language may, on occasion, be indicated by relevant internal evidence of the statute itself and necessary in order to effect the legislative purpose. See, *e. g.*, *Board of Governors* v. *Agnew*, 329 U. S. 441, 446–448. But this is not such an occasion. The purpose of the statutory provision with which we deal is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand (*Corn Products Co.* v. *Commissioner*, 350 U. S. 46, 52) and "the realization of appreciation in value accrued over a substantial period of time" on the other. (*Commissioner* v. *Gillette Motor Co.*, 364 U. S. 130, 134). A literal reading of the statute is consistent with this legislative purpose. We hold that, as used in § 1221 (1), "primarily" means "of first importance" or "principally."

Since the courts below applied an incorrect legal standard, we do not consider whether the result would

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sioner, 341 F. 2d 683, 688–689 (C. A. 8th Cir.). Cf. *Recordak Corp.* v. *United States*, 325 F. 2d 460, 463–464 (Ct. Cl.).

be supportable on the facts of this case had the correct one been applied. We believe, moreover, that the appropriate disposition is to remand the case to the District Court for fresh fact-findings, addressed to the statute as we have now construed it.

Vacated and remanded.

MR. JUSTICE BLACK would affirm the judgments of the District Court and the Court of Appeals.

MR. JUSTICE WHITE took no part in the decision of this case.

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